



## **FEDERAL RESERVE SYSTEM**

### **12 CFR Part 242**

#### **Regulation PP; Docket No. R-1405**

#### **RIN 7100-AD64**

### **Definitions of “Predominantly Engaged In Financial Activities” and “Significant” Nonbank Financial Company and Bank Holding Company**

**AGENCY:** Board of Governors of the Federal Reserve System (“Board”).

**ACTION:** Final rule.

**SUMMARY:** The Board is adopting this final rule to establish, for purposes of Title I of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act” or “Act”), the requirements for determining if a company is “predominantly engaged in financial activities”; and definitions of the terms “significant nonbank financial company” and “significant bank holding company.” These terms are relevant to various provisions of Title I of the Dodd-Frank Act, including section 113, which authorizes the Financial Stability Oversight Council (“Council”) to designate a nonbank financial company for supervision by the Board if the Council determines that the nonbank financial company could pose a threat to the financial stability of the United States.

**DATES:** The final rule will become effective on [insert 30 days after Federal Register publication].

**FOR FURTHER INFORMATION CONTACT:** Laurie Schaffer, Associate General Counsel (202) 452-2272, Paige E. Pidano, Counsel, (202) 452-2803, or Christine E. Graham, Senior Attorney, (202) 452-3005, Legal Division; or Felton C. Booker, Senior

Supervisory Financial Analyst, (202) 912-4651, Division of Banking Supervision and Regulation, Board of Governors of the Federal Reserve System, 20<sup>th</sup> Street and Constitution Avenue, NW, Washington, DC 20551. Users of Telecommunication Device for Deaf (TDD) only, call (202) 263-4869.

## **SUPPLEMENTARY INFORMATION:**

### **I. Background**

The Dodd-Frank Act established the Council, which, among other authorities and duties, may subject a “nonbank financial company” to supervision by the Board and consolidated prudential standards if the Council determines that material financial distress at the nonbank financial company, or the nature, scope, size, scale, concentration, interconnectedness, or mix of the company’s activities, could pose a threat to the financial stability of the United States.<sup>1</sup> Nonbank financial companies that are designated by the Council under section 113 of the Dodd-Frank Act are referred to as “nonbank financial companies supervised by the Board.”<sup>2</sup>

The authority of the Council to subject a nonbank financial company to consolidated prudential supervision by the Board is an important component of recent legislative and regulatory changes designed to address gaps and weaknesses in the financial regulatory system that became evident during the financial crisis. These gaps often allowed financial firms whose failure could pose substantial risks to the financial stability of the United States to avoid prudential, consolidated supervision.

---

<sup>1</sup> See section 113 of the Dodd-Frank Act; 12 U.S.C. 5323.

<sup>2</sup> See section 102(a)(4)(D) of the Dodd-Frank Act; 12 U.S.C. 5311(a)(4)(D).

Title I of the Dodd-Frank Act defines a “nonbank financial company” to include both a U.S. nonbank financial company and a foreign nonbank financial company. The statute, in turn, defines a “U.S. nonbank financial company” as a company (other than a bank holding company and certain other specified types of entities) that is

- (i) incorporated or organized under the laws of the United States or any State; and
- (ii) *predominantly engaged in financial activities*.<sup>3</sup>

A “foreign nonbank financial company” is defined as a company (other than a company that is, or is treated as, a bank holding company) that is (i) incorporated or organized outside the United States; and (ii) *predominantly engaged in financial activities*.<sup>4</sup>

For purposes of Title I of the Dodd-Frank Act, a company is considered to be “predominantly engaged” in financial activities if *either* (i) the annual gross revenues derived by the company and all of its subsidiaries from financial activities, as well as from the ownership or control of an insured depository institution, represent 85 percent or more of the consolidated annual gross revenues of the company; or (ii) the consolidated

---

<sup>3</sup> See section 102(a)(4)(B) of the Dodd-Frank Act (emphasis added); 12 U.S.C. 5311(a)(4)(B) (emphasis added). Besides bank holding companies, the statute specifically provides that the term “U.S. nonbank financial company” does not include (i) a Farm Credit System institution chartered and subject to the Farm Credit Act of 1971 (12 U.S.C. 2001 *et seq.*), (ii) a national securities exchange (or parent thereof), clearing agency (or parent thereof, unless the parent is a bank holding company), security-based swap execution facility, or security-based swap data repository that in each case is registered with the SEC, or (iii) a board of trade designated as a contract market (or parent thereof), or a derivatives clearing organization (or parent thereof, unless the parent is a bank holding company), swap execution facility or a swap data repository that in each case is registered with the CFTC.

<sup>4</sup> See section 102(a)(4)(A) of the Dodd-Frank Act (emphasis added); 12 U.S.C. 5311(a)(4)(A) (emphasis added). A foreign bank, or foreign company controlling a foreign bank, is treated as a bank holding company for purposes of the BHC Act if the foreign bank has a branch, agency, or commercial lending company subsidiary in the United States and does not control a U.S. bank.

assets of the company and all of its subsidiaries related to financial activities, as well as related to the ownership or control of an insured depository institution, represent 85 percent or more of the consolidated assets of the company.<sup>5</sup> The Dodd-Frank Act requires the Board to establish the requirements for determining if a company is “predominantly engaged in financial activities.”<sup>6</sup>

Section 165(d)(2) of the Dodd-Frank Act also requires nonbank financial companies supervised by the Board and bank holding companies with total consolidated assets of \$50 billion or more to disclose the nature and extent of (i) the company’s credit exposure to other significant nonbank financial companies and significant bank holding companies; and (ii) the credit exposure of such significant entities to the company.<sup>7</sup> The terms “significant nonbank financial company” and “significant bank holding company” are used in section 113 of the Dodd-Frank Act as well, which specifies that the Council must consider the extent and nature of a nonbank company’s transactions and relationships with other “significant nonbank financial companies” and “significant bank holding companies,” among other factors, in determining whether to designate a nonbank financial company for supervision by the Board.<sup>8</sup> The Act does not define the terms “significant nonbank financial company” or “significant bank holding company,” but instead directs the Board to define those terms by rule.<sup>9</sup>

---

<sup>5</sup> See section 102(a)(6) of the Dodd-Frank Act (emphasis added); 12 U.S.C. 5311(a)(6).

<sup>6</sup> See section 102(b) of the Dodd-Frank Act; 12 U.S.C. 5311(b).

<sup>7</sup> See section 165(d)(2) of the Dodd-Frank Act; 12 U.S.C. 5365(d)(2).

<sup>8</sup> See sections 113(a)(2)(C) and (b)(2)(C) of the Dodd-Frank Act; 12 U.S.C. 5323(a)(2)(C) and (b)(2)(C).

<sup>9</sup> See sections 102(a)(7) and (b) of the Dodd-Frank Act; 12 U.S.C. 5311(a)(7) and (b).

On February 11, 2011, the Board invited comment on a proposed rule that would have (i) established the requirements for determining if a company is “predominantly engaged in financial activities” for purposes of Title I of the Act and (ii) defined the terms “significant nonbank financial company” and “significant bank holding company” (“First NPR”).<sup>10</sup> In response to the First NPR, the Board received 23 comments, including comments related to the definition of activities that are financial for purposes of Title I.

Among other things, these comments indicated that some commenters believed that a firm engaged in financial activities could avoid designation simply by choosing not to comply with the conditions imposed on the manner in which those activities must be conducted by bank holding companies. After considering those comments, as well as the language and legislative intent and history of the Dodd-Frank Act and the Bank Holding Company Act (“BHC Act”), as amended by the Gramm-Leach-Bliley Act (“GLB Act”), on April 2, 2012, the Board invited comment on an amendment to the First NPR to clarify that, consistent with the purpose of Title I, any activity referenced in section 4(k) of the BHC Act will be considered to be a financial activity without regard to conditions that do not define whether an activity is itself financial but were imposed on bank holding companies to ensure that the activity is conducted by bank holding companies in a safe and sound manner or to comply with another provision of law (“Second NPR”).<sup>11</sup> In the Second NPR, the Board proposed an appendix of the list of the activities that would be considered to be financial activities as of April 2, 2012, together with conditions the

---

<sup>10</sup> 76 FR 7731 (February 11, 2011).

<sup>11</sup> 77 FR 21494 (April 10, 2012).

Board believed necessary to define the activity as a financial activity and excluding conditions that the Board believed were related to the safe and sound conduct of the activity, compliance with other law, or other factors not related to whether the activity was financial, for purposes of determining whether a company is predominantly engaged in financial activities. In response to the Second NPR, the Board received 12 comments.

## **II. Explanation of Final Rule**

The final rule provides clarity for purposes of determining whether particular companies qualify as nonbank financial companies under Title I of the Dodd-Frank Act. This is important both in the context of Council designation as well as for large bank holding companies and nonbank financial companies that are required to report their credit exposures to other significant nonbank financial companies pursuant to section 165(d). In developing this final rule, the Board has considered the comments received on both the First and Second NPRs and the language and purposes of the relevant statutory provisions. In addition, the Board consulted with the other Council members and member agencies.

After this review, the Board has determined to adopt the attached final rule, which includes several modifications of the earlier proposals to address matters raised by commenters.

### **A. Predominantly Engaged in Financial Activities**

#### **1. Two-Year Test Based on Consolidated Financial Statements**

The First NPR provided that a company would be considered to be predominantly engaged in financial activities if:

- The consolidated annual gross financial revenues of the company in either of its two most recently completed fiscal years represent 85 percent or more of the company’s consolidated annual gross revenues (as determined in accordance with applicable accounting standards) in that fiscal year; *or*
- The consolidated total financial assets of the company as of the end of either of its two most recently completed fiscal years represent 85 percent or more of the company’s consolidated total assets (as determined in accordance with applicable accounting standards) as of the end of that fiscal year.<sup>12</sup>

Several commenters asserted that the 85 percent threshold in the revenue and asset tests was too high and that a company should be considered to be “predominantly engaged in financial activities” if a lower percentage of the company’s revenues are derived from, or a lower percentage of its assets are related to, activities that are financial in nature. The statutory language of the Act establishes that a company will be considered to be predominantly engaged in financial activities if either 85 percent of its revenues are derived from, or 85 percent of its assets are related to, financial activities. The Board does not have the discretion to lower the 85 percent threshold established by Congress. Therefore, the final rule retains the revenue and asset tests described above as proposed in the First NPR.

The final rule also retains the proposed definition of “consolidated annual gross financial revenues” of a company. A company’s consolidated annual gross financial revenues would be determined in accordance with applicable accounting standards, and are that portion of the consolidated annual gross revenues derived directly by the company, or indirectly by any of its consolidated subsidiaries, from: (i) activities that are financial in nature; or (ii) the ownership, control, or activities of an insured depository

---

<sup>12</sup> See § 225.301(a)(1) and (2) of the First NPR and § 242.3(a)(1) and (2) of the Final Rule.

institution or any subsidiary of an insured depository institution.<sup>13</sup> Similarly, the final rule retains the proposed definition of “consolidated total financial assets” of a company, which is that portion of the company’s consolidated total assets, as determined in accordance with applicable accounting standards, that are related to (i) activities that are financial in nature, or (ii) the ownership, control, or activities of an insured depository institution or any subsidiary of an insured depository institution.<sup>14</sup>

As in the First NPR, the final rule provides that computation of assets and revenues for purposes of determining if a company meets the statutory threshold would be based on the relevant company’s annual financial revenues in, or financial assets at the end of, *either* of its two most recent fiscal years. This methodology is designed to account for transitory fluctuations in assets and revenues that may not be indicative of any substantive change in the financial nature of the company or its predominant activities and to allow the Council to effectively fulfill its important responsibilities of designating (and reviewing existing designations of) those nonbank financial companies whose material financial distress could pose a threat to the financial stability of the United States.

## **2. Activities that are Financial in Nature**

The Dodd-Frank Act provides that financial activities are those activities that have been defined as financial in nature in section 4(k) of the BHC Act.<sup>15</sup> In response to

---

<sup>13</sup> See § 242.3(b) of the Final Rule.

<sup>14</sup> See § 242.3(c) of the Final Rule.

<sup>15</sup> See section 102(a)(6) of the Dodd-Frank Act; 12 U.S.C. 5311(a)(6).



issues raised by comments received on the First NPR, the Board invited comment in the Second NPR on a proposal that any activity described in section 4(k) of the BHC Act would be considered financial in nature under Title I regardless of whether the activity is conducted in conformance with conditions imposed on bank holding companies conducting the activity that do not define the financial activity itself, such as conditions related to safety and soundness or related to compliance with another provision of law, such as the Glass-Steagall Act. The Second NPR included an appendix that enumerated the activities and related conditions the Board proposed to retain as part of the definitions of financial activities under section 4(k) of the BHC Act.

The Board received several comments on the approach taken in the Second NPR. One commenter expressed support for the approach proposed in the Second NPR, while others raised questions regarding the approach. The final rule generally maintains the approach set forth in the Second NPR, with certain modifications that address matters raised by commenters, including the restoration of several conditions the Board proposed to remove in the Second NPR.

The Board also received several comments on the First NPR requesting clarity regarding the relationship between certain types of assets and revenues and financial activities. These comments and the Board's responses are described in greater detail below.

**a. Scope of Financial Activities**

Some commenters asserted that the Board does not have the authority to issue regulations regarding the scope of activities that are financial in nature for purposes of Title I. One commenter asserted that, while the Dodd-Frank Act expressly provides the

Board with rulemaking authority regarding the requirements for determining whether a company is predominantly engaged in financial activities, the Board’s rulemaking authority is limited to establishing technical guidelines for calculating a company’s financial revenues or assets in assessing whether a particular company and its activities fall within the defined terms of “predominantly engaged” and “financial activities,” such as identifying the accounting methods that may be used in these calculations.<sup>16</sup>

The Board believes that the approach taken in the Second NPR is authorized under the Dodd-Frank Act’s grant of authority to the Board in section 102(b) to establish, by regulation, the requirements for determining if a company is predominantly engaged in financial activities, as defined in section 102(a)(6) of the Dodd-Frank Act.<sup>17</sup> Section 102(a)(6) provides that a company is “predominantly engaged in financial activities” if more than 85 percent of the company’s and its subsidiaries’ annual gross revenues are derived from, or more than 85 percent of the company’s and its subsidiaries’ consolidated assets are related to, “activities that are financial in nature” as defined in section 4(k) of the BHC Act. The identification of the scope of activities that are “financial in nature” as defined in section 4(k) of the BHC Act is a necessary requirement for determining whether a company is predominantly engaged in financial activities and, thus, is within the Board’s rulemaking authority under section 102(b).

---

<sup>16</sup> See letter dated May 25, 2012, to Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System, from David T. Hirschmann, President and Chief Executive Officer, Center for Capital Markets Competitiveness, U.S. Chamber of Commerce, p. 3.

<sup>17</sup> See section 102(b) of the Dodd-Frank Act, 12 U.S.C. 5311(b).

As noted, section 102(a)(6) refers to “activities that are financial in nature (as defined in section 4(k) of the Bank Holding Company Act of 1956)).” Section 4(k) of the BHC Act, added by the GLB Act, authorizes bank holding companies that qualify as “financial holding companies” to engage in a wide range of financial activities.<sup>18</sup> Section 4(k) defines as “financial” a list of Congressionally-authorized activities added by the GLB Act and activities previously approved by the Board for bank holding companies pursuant to sections 4(c)(8) and (13) of the BHC Act, which are incorporated by reference. Section 4(k) and the Board’s rules implementing sections 4(c)(8) and (13) also impose conditions on the conduct of some of those activities for safety and soundness reasons or to comply with other provisions of law. Some of the Congressionally-authorized activities for financial holding companies, such as lending, overlap completely with activities that had been authorized by the Board for bank holding companies. Others expanded the authorization of activities previously approved by the Board for bank holding companies, such as certain insurance activities, by removing the conditions that apply to bank holding companies engaging in the activity. Bank holding companies that are not financial holding companies may only engage in activities previously approved by the Board under sections 4(c)(8) and 4(c)(13) of the BHC Act and are subject to the related conditions.

While the BHC Act is clear as to the type and scope of activities that are permissible for each category of bank holding company, section 102(b) of the Dodd-

---

<sup>18</sup> 12 U.S.C. 1843(l)(1). To engage in the broad range of activities authorized by section 4(k), a bank holding company must be well-capitalized and well managed, and its subsidiary insured depository institutions must also be well-capitalized and well-managed and have ‘satisfactory’ ratings under the Community Reinvestment Act.

Frank Act is silent as to how the overlapping definitions of financial activities and related conditions incorporated in section 4(k) should be applied in determining whether companies that are not bank holding companies are predominantly engaged in financial activities for purposes of Title I. Because section 102 does not address how to apply these overlapping and sometimes inconsistent definitions of financial activities or how to apply the related conditions incorporated in section 4(k) in assessing the financial activities of nonbank firms, the reference in section 102 of the Dodd-Frank Act to financial activities “as defined in section 4(k)” is ambiguous. As the agency with sole authority to “establish, by regulation, the requirements for determining if a company is predominantly engaged in financial activities, as defined in section 102(a)(6),” it is appropriate for the Board to resolve this ambiguity.<sup>19</sup>

Under Supreme Court precedent, a statutory term defined by cross-reference to another statute is not alone evidence of clear Congressional intent that the implementing agency construe the term identically. In *Environmental Defense v. Duke Energy Corp.* (“Duke”),<sup>20</sup> the Court held that the general presumption of statutory construction “that the same term has the same meaning when it occurs here and there in a single statute,” may be overcome where context indicates that the term was intended to be construed differently.<sup>21</sup>

---

<sup>19</sup> See section 102(b) of the Dodd-Frank Act, 12 U.S.C. 5311(b).

<sup>20</sup> 549 U.S. 561 (2007).

<sup>21</sup> See *id.* at 574, 576, citing *Atlantic Cleaners & Dyers, Inc. v. United States*, 286 U.S. 427, 433. The Court considered whether the Environmental Protection Agency (“EPA”) was required to interpret the term “modification” identically where one section of the Clean Air Act (“CAA”) defined “modification” “as defined in” a different section of the CAA. The Court held that when considering whether a term that is used in different

Consistent with the Court’s analysis in *Duke*, the Board believes that neither the text, the context in which the text appears, nor the legislative purpose or history of the Dodd-Frank Act suggests that Congress intended that a nonbank company must engage in financial activities in compliance with all the conditions and requirements imposed under section 4(k) and the Board’s implementing regulations in order for the company to be considered to be engaged in the relevant financial activity. A reading of Title I that limited the scope of companies considered to be “predominantly engaged in financial activities” to only those companies that conduct activities in compliance with the conditions applicable to bank holding companies would undermine the purpose of Title I and the authority granted by Congress to the Council to protect U.S. financial stability.<sup>22</sup> Defining financial activities for purposes of Title I to include all of the conditions imposed on the conduct of the activities by bank holding companies would lead to the absurd result that some companies that are predominantly engaged in financial activities could avoid consideration for designation by the Council simply by choosing not to abide by one or more conditions that were imposed on bank holding companies to ensure the safe and sound conduct of the activity or compliance with other legal restrictions unrelated to whether the activity is a financial activity.

---

statutes must be interpreted identically, “context counts.” See *id.* at 575-76, citing United States v. Cleveland Indians Baseball Co., 532 U.S. 200, 213 (2001). The Court considered the context in which the term “modification” was used and the legislative history of the relevant statutory provisions and found no evidence of Congressional intent that “modification” be construed identically by the EPA despite the cross-reference to the term in the statute because the contexts in which the term was used and the purposes of each use were different.

<sup>22</sup> Committee on Banking, Housing, and Urban Affairs Report, S. Rep. No. 111-176, April 15, 2010, page 3, citing Testimony of Timothy Geithner, Secretary of the Treasury, to the Banking Committee, June 18, 2009.

The Board’s proposed approach to addressing the scope of activities is consistent with Congressional intent as reflected in Title I as well the legislative history of the Dodd-Frank Act. Other sections of Title I support the view that Congress intended that companies could be eligible for designation by the Council regardless of whether these companies complied with the non-definitional conditions applied to bank holding companies in the implementation of section 4(k). For instance, section 167(a) provides that a nonbank financial company supervised by the Board is not required “to conform its activities to the *requirements* of section 4 of the BHC Act.”<sup>23</sup> This section demonstrates that Congress recognized that nonbank financial companies do not conduct their activities in compliance with the requirements applicable to bank holding companies. It would be illogical to conclude that a company would be *eligible* for Council designation *only* if it conducted its financial activities in conformance with the requirements imposed on bank holding companies’ conduct of financial activities set forth in section 4(k), but would not be required to conform its financial activities to the conditions imposed on bank holding companies by section 4(k) *after being designated* by the Council for Board supervision.

In addition, the Council’s anti-evasion authority demonstrates Congress’s intent to give the Council the authority to consider a broad range of nonbank financial companies for designation.<sup>24</sup> Section 113(c) of the Dodd-Frank Act gives the Council the authority to subject the financial activities of *any* company to supervision by the Board if the Council determines, either on its own or pursuant to a recommendation by the Board, that: (i) the company is organized and operates in such a manner to evade application of

---

<sup>23</sup> See 12 U.S.C. 5367.

<sup>24</sup> See 12 U.S.C. 5323(c).

Title I of the Dodd-Frank Act; and (ii) material financial distress related to, or the nature, scope, size, scale, concentration, interconnectedness, or mix of, the company's financial activities would pose a threat to the financial stability of the United States.<sup>25</sup> Companies that are engaged in activities that are financial in nature, but that alter the manner in which they conduct those activities such that they evade designation by the Council under section 113 and supervision by the Board may be subject to designation by the Council under the special anti-evasion authority in section 113(c).

The legislative history of the Dodd-Frank Act demonstrates that Congress believed that the statutory definition of a “nonbank financial company” would make eligible for Council designation companies that were not bank holding companies but that engaged in a broad range of financial activities. For instance, several members of Congress indicated that, while in their view designation may not be appropriate for mutual funds, the activities conducted by mutual funds, which typically do not conform to the prudential conditions imposed on the investment advisory or management activities of bank holding companies, were financial activities for purposes of Title I.<sup>26</sup> In addition,

---

<sup>25</sup> See id.

<sup>26</sup> See, for example, 156 Cong. Rec. S5873 (daily ed. July 15, 2010) (statement of Sen. Cardin) (indicating that mutual funds and their advisers would be eligible for designation by the Council by stating that section 115 of the Dodd-Frank Act would “ensure that mutual funds and their advisers are not inadvertently subjected to unworkable standards in the unlikely event the Financial Stability Oversight Council designates [mutual funds] as systemically risky”); See also 156 Cong. Rec. S5902-5903 (daily ed. July 15, 2010) (statement of Sen. Kerry) (indicating that although mutual funds and their advisers would be eligible for designation by the Council, regulation by the Board may not be appropriate for such companies because they do not pose a risk to United States financial stability, by stating that “there are large companies providing financial services that are in fact traditionally low-risk businesses, such as mutual funds and mutual fund advisers” and that Congress did “not envision nonbank financial companies that pose little risk to

section 165 of the Dodd-Frank Act, which sets forth the enhanced prudential standards applicable to nonbank financial companies designated by the Council, further illustrates that Congress believed that the activities of investment companies were financial activities. Section 165(b)(1)(A)(i) requires the Board to impose risk-based capital requirements and leverage limits on nonbank financial companies designated by the Board and certain bank holding companies, “unless the Board of Governors, in consultation with the Council, determines that such requirements are not appropriate for a company subject to more stringent prudential standards because of the activities of such company (such as investment company activities or assets under management) or structure, in which case, the Board of Governors shall apply other standards that result in similarly stringent risk controls.”<sup>27</sup> This statutory requirement indicates that Congress believed that investment company activities were financial.

Moreover, references in section 4(k) itself distinguish between financial activities and the conditions imposed on those activities. Among the activities that section 4(k) defines as being “financial in nature” are all of the activities that the Board had determined, by regulation or order, prior to November 12, 1999, to be “so closely related to banking or managing or controlling banks as to be a proper incident thereto (subject to the same terms and conditions contained in such order or regulation, unless modified by the Board)” under section 4(c)(8) of the BHC Act.<sup>28</sup> By recognizing that the Board could modify the terms and conditions in the orders and rules authorizing these activities,

---

the stability of the financial system,” such as mutual funds and mutual fund advisers, “to be supervised by the Federal Reserve”).

<sup>27</sup> See section 165(b)(1)(A)(i) of the Dodd-Frank Act; 12 U.S.C. 5365(b)(1)(A)(i).

<sup>28</sup> See 12 U.S.C. § 1843(k)(4)(F).



section 4(k) itself recognizes that these terms and conditions do not necessarily determine whether the activity is a financial activity. Pursuant to section 4(k), an activity authorized under section 4(c)(8) is a financial activity regardless of the conditions imposed by rule or order—all of which may be modified or removed.”<sup>29</sup>

One commenter expressed support for the Board’s proposal to consider financial activities without regard to the conditions imposed on the conduct of the activities by bank holding companies when considering whether a company is predominantly engaged in financial activities for purposes of Title I.<sup>30</sup> The commenter argued that defining financial activities for purposes of Title I to include all of the conditions imposed on the conduct of the activities by bank holding companies would enable some companies that are predominantly engaged in financial activities to avoid consideration for designation

---

<sup>29</sup> Distinguishing between the definition of an activity and conditions imposed for reasons related to other policy and statutory factors is consistent with the Board’s long-standing interpretations of the BHC Act, which is the Act to which section 102 of the Dodd-Frank Act refers. For example, in the Board’s 1997 revisions to Regulation Y (“1997 rulemaking”), the Board removed several of the conditions imposed on bank holding companies conducting activities that are “closely related to banking” by distinguishing between the conditions that were “necessary to establish the definition of the permitted activity” and those that were imposed for other purposes, such as “to prevent circumvention of another statute, such as the Glass-Steagall Act. See 62 FR 9290, 9305 (February 28, 1997). The Board stated that the revisions made by the 1997 rulemaking were necessary to remove conditions that “[were] outmoded, [were] superseded by Board order, or [did] not apply to insured depository institutions conducting those same activities,” and the conditions retained in section 225.28 were “necessary to establish the definition of the permitted activity or to prevent circumvention of another statute, such as the Glass-Steagall Act.” The Board further noted that its “removal of [such] restrictions from the regulation does not affect the Board’s determination that” these activities are “so closely related to banking as to be a proper incident thereto” and thus permissible for bank holding companies.

<sup>30</sup> See letter dated May 24, 2012, to Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System, from Christopher Cole, Senior Vice President and Senior Regulatory Counsel, Independent Community Bankers of America.

by the Council simply by choosing not to comply with conditions imposed for prudential or other reasons on the manner in which the activities must be conducted by bank holding companies. Some commenters questioned the approach taken in the Second NPR to the extent that it appeared that the approach might cover activities routinely conducted by non-financial firms such as manufacturers or retailers. In these commenters' view, an overly broad interpretation of the definition of financial activities subverts the "85-percent" test imposed by statute. In the final rule, the Board has addressed commenters' concerns that activities routinely conducted by non-financial companies could be considered financial through restoration of some of the conditions.

#### **b. Description of "Financial Activities"**

In determining whether or not to include a condition imposed on the scope of an activity or the manner in which an activity may be conducted, the Board considered many factors, including the information and views presented by commenters. The Board also reviewed the statutory language of section 4(k) of the BHC Act and the Board's releases related to the activities that are financial in nature under section 4(k). In addition, the Board reviewed the legislative history of the GLB Act, which itself removed or modified many of the conditions applicable to the conduct of financial activities by bank holding companies and financial holding companies.<sup>31</sup>

---

<sup>31</sup> In amending Regulation Y consistent with the GLB Act, the Board noted that the GLB Act eliminated many of the "detailed restrictions on relationships and transactions between depository institutions and securities affiliates" that had been required prior to the passage of the GLB Act. See 65 FR 14440, 14441 (March 17, 2000). The Board also noted that in light of the GLB Act "securities underwriting, dealing, and market making . . . is authorized for financial holding companies in a broader form" than had previously been permitted. See id. at 14433, 14435 (March 17, 2000).

As an initial matter, the Board notes that the only role of this rulemaking is to define activities that are financial. This rulemaking does not designate any specific entity for enhanced supervision under Title I of the Dodd-Frank Act. Authority to designate an entity for enhanced supervision rests exclusively with the Council. Thus, clarity regarding whether any specific entity will be designated under Title I must come from other agencies.<sup>32</sup>

In the Second NPR, the Board noted that the list of financial activities authorized under section 4(k) included overlapping and redundant activities, and invited comment on whether overlapping or redundant financial activities should be combined or removed, as appropriate, solely for purposes of determining whether a nonbank company is predominantly engaged in financial activities, in order to reduce the ambiguity created by these overlapping and sometimes inconsistent activities and to simplify the proposed appendix. The Board did not receive comment on this request, and, consistent with the Second NPR, the Board has maintained the complete list of financial activities authorized

---

<sup>32</sup> As noted previously, Title I of the Dodd-Frank Act authorizes the Council to take certain actions with respect to nonbank financial companies, including designating a nonbank financial company for Board supervision pursuant to section 113 and issuing recommendations under section 120 to a primary financial regulatory agency to apply new or heightened standards to a financial activity conducted by nonbank financial companies under the jurisdiction of that regulatory agency. A nonbank financial company is a company that is predominantly engaged in financial activities. Therefore, the application of the definitions of financial activities and the determination that a company is predominantly engaged in financial activities will be subject to review by the Council with respect to an action taken by the Council involving nonbank financial companies under Title I of the Dodd-Frank Act. 12 U.S.C. 5323(a) and (b). The Dodd-Frank Act provides a specific procedure in the designations process under which a company may challenge the Council's proposed determination that the nonbank financial company could pose a threat to U.S. financial stability and shall be subject to Board supervision. 12 U.S.C. 5323(e) and (h).

under section 4(k), including the overlapping and redundant activities, in order to ensure completeness and to avoid confusion based on the specific statutory authority relied on in defining an activity. To reduce the ambiguity created by the overlapping and redundant descriptions of financial activities included in the appendix, a company that engages in a particular activity in a manner that does not comply with the narrower definition of the particular activity will be considered to be engaged in a financial activity if its activities are captured by the broader description of the activity.

The following discussion describes the activities enumerated in the appendix to the final rule that are financial in nature as defined in section 4(k) of the BHC Act for purposes of determining whether a company is predominantly engaged in financial activities. The discussion also identifies the conditions imposed in section 4(k) or by the Board's implementing regulations pursuant to sections 4(c)(8) and (13) that are not reflected in the appendix because they were imposed for safety and soundness considerations or to comply with other provisions of law and, thus, are not relevant for determining whether these activities are considered financial for purposes of determining whether a firm is predominantly engaged in financial activities. As noted previously, the final rule reinstates several conditions that the Board proposed to remove from the definitions of financial activities in the Second NPR. The final rule retains all of the conditions set forth in the description of financial activities specifically enumerated under section 4(k), other than two conditions with respect to the activity of investing as part of a bona fide underwriting or merchant or investment banking activity, and one condition with respect to insurance company portfolio investments, which do not define the activity

itself and were imposed for safety and soundness reasons and to ensure compliance with other provisions of law.

**i. Financial activities added to the BHC Act by the GLB Act**

The following financial activities were authorized for financial holding companies and added to section 4(k) of the BHC Act by the GLB Act. These activities are financial activities for purposes of determining whether a firm is predominantly engaged in financial activities under Title I.

- ***Lending, exchanging, transferring, investing for others, and safeguarding money or securities***

The activities of lending, exchanging, transferring, investing for others, or safeguarding money or securities are specifically enumerated, without conditions, in section 4(k) of the BHC Act.<sup>33</sup> The activity of “investing for others” includes buying, selling, or otherwise acquiring and disposing of money or securities in order to benefit from changes in the value of those assets and distribute profits to investors. These activities are often conducted by investment advisors, wealth managers, limited purpose trust companies, mutual funds, hedge funds, private equity funds, real estate investment trusts, and similar vehicles.

One commenter asserted that the Board had not authorized bank holding companies to control or be an open-end investment company and that, as a result, open-end investment companies cannot be found to be engaged in financial activities as defined in section 4(k) of the BHC Act. The commenter argued that open-end investment companies (e.g., mutual funds) are not engaged in a financial activity as defined in

---

<sup>33</sup> 12 U.S.C. 1843(k)(4)(A).

section 4(k) of the BHC Act, and that the Board should “reduce uncertainty created by the ambiguity in Title I . . . to make clear to investors and the public that [money market mutual funds] will *not* be designated . . . under Title I” of the Dodd-Frank Act.<sup>34</sup> The crux of this commenter’s argument is the assertion that the Board has not issued any order approving an application or request by a bank holding company to be or to control a mutual fund<sup>35</sup> and therefore such activities cannot be considered to be financial.

The Board believes that it is clear that open-end investment companies, such as mutual funds including money market funds, as well as closed-end investment companies, engage in financial activities as defined in section 4(k) of the BHC Act. The Board’s regulations have long authorized bank holding companies to engage in organizing, sponsoring, and managing mutual funds and closed-end investment companies and serving as an investment adviser to mutual funds and closed-end investment companies and others using authority described in section 4(k) of the BHC Act.<sup>36</sup> As the commenter recognized, prior to enactment of the GLB Act in 1999, the Board permitted bank holding companies to own more than 5 percent (and up to 25 percent) of the shares of an open-end investment company—a determination that

---

<sup>34</sup> See letter dated March 30, 2011, to Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System, from John D. Hawke, Jr., Arnold & Porter LLP, p. 7 (emphasis in original).

<sup>35</sup> See *id.* at p. 8.

<sup>36</sup> See, e.g., 12 CFR 211.10(a)(11); 225.28(b)(6)(i); 225.86(b)(3); and 225.125. See also, e.g., Mellon Bank Corporation, 79 Federal Reserve Bulletin 626 (1993), and Bayerische Vereinsbank AG, 73 Federal Reserve Bulletin 155 (1987).

represents a finding that open-end investment companies engage in a financial activity.<sup>37</sup> The investment limitation reflects a decision by the Board that the public benefits of allowing a bank holding company to own more than 25 percent of the shares of a mutual fund did not outweigh the potential costs consequent with treating the mutual fund as a subsidiary of the bank holding company. Under the BHC Act, the decision to allow a bank holding company to own more than 5 percent of the shares of a mutual fund is sufficient to indicate that the mutual fund itself, which is a company, is engaged in a financial activity.<sup>38</sup> The activity of organizing, sponsoring, and managing a mutual fund was also determined to be usual in connection with the transaction of banking or other financial operations abroad prior to November 11, 1999, and, thus, is incorporated as a financial activity in section 4(k) by the GLB Act.<sup>39</sup> The Board's regulations prohibit bank holding companies from exerting managerial control over the companies in which the mutual fund invests and require bank holding companies to reduce their ownership to less than 25 percent of the equity of the mutual fund within one year of sponsoring the fund.<sup>40</sup> These limitations were imposed to prevent circumvention of the investment restrictions in the BHC Act.

---

<sup>37</sup> See letter dated June 24, 1999, to H. Rodgin Cohen, Esq., Sullivan & Cromwell (First Union Corporation), from Jennifer J. Johnson, Secretary of the Board of Governors of the Federal Reserve System. See also 12 CFR 225.86(b)(3).

<sup>38</sup> Bank holding companies are generally prohibited from owning more than 5 percent of the voting shares of a company unless that company is engaged only in a financial activity. See 12 U.S.C. 1843(a).

<sup>39</sup> 12 U.S.C. 1843(k)(4)(G); 12 CFR 225.86(b)(3).

<sup>40</sup> 12 CFR 225.86(b)(3).

Moreover, section 4(k) itself authorizes all of the component activities in which a mutual fund engages — investing for others,<sup>41</sup> merchant banking,<sup>42</sup> investment advice,<sup>43</sup> and underwriting<sup>44</sup> — as financial. These activities are defined as financial under section 4(k) separately from, and in addition to, those activities previously approved by the Board as being so closely related to banking as to be a proper incident thereto, or usual in connection with the transaction of banking or other financial operations abroad, which are incorporated into the definition of financial activities in section 4(k).<sup>45</sup>

Section 4(k) specifically defines the activities of underwriting, dealing in, or making a market in securities as a financial activity, which includes key components of sponsoring and distributing mutual funds and investment companies. Section 4(k) also specifically enumerates as financial activities providing financial, investment, and economic advisory services and investing for others, which includes buying, selling, or otherwise acquiring and disposing of money or securities in order to benefit from changes in the value of those assets and distribute profits to investors. Similarly, section 4(k) authorizes merchant banking activities—which represent investments made for the purpose of profiting from price appreciation—as financial.

---

<sup>41</sup> 12 U.S.C. 1843(k)(4)(A).

<sup>42</sup> 12 U.S.C. 1843(k)(4)(H).

<sup>43</sup> 12 U.S.C. 1843(k)(4)(C).

<sup>44</sup> 12 U.S.C. 1843(k)(4)(E).

<sup>45</sup> In amending Regulation Y consistent with the GLB Act, the Board added the financial activities added to section 4(k) by the GLB Act and noted that in light of the passage of the GLB Act “securities underwriting, dealing, and market making . . . is authorized for financial holding companies in a broader form” than had previously been permitted. See 65 FR 14440, 14443, 14435 (March 17, 2000).



The fact that the Board has imposed prudential conditions on bank holding companies engaged in the activity of organizing, sponsoring, or managing a mutual fund does not negate the fact that the activity is financial for purposes of section 4(k).<sup>46</sup> Moreover, while open-end investment companies (and other investment vehicles) have not applied to become bank holding companies, the Board does not believe that this in any way reflects a judgment that the companies are not engaged in financial activities. It is more likely a reflection that open-end investment companies (and similar investment vehicles) have chosen not to control banks in order to avoid the capital, risk management, and other supervisory requirements attendant to becoming a bank holding company.

- ***Insurance activities***

Insuring, guaranteeing, or indemnifying against loss, harm, damage, illness, disability, or death, or providing and issuing annuities, and acting as principal, agent, or broker for purposes of the foregoing, in any state, are financial activities specifically enumerated in section 4(k) of the BHC Act.<sup>47</sup>

---

<sup>46</sup> As noted previously, bank holding companies are generally prohibited from owning more than 5 percent of the voting shares of a company unless that company is engaged only in a financial activity. See 12 U.S.C. 1843(a).

<sup>47</sup> 12 U.S.C. 1843(k)(4)(B). In amending Regulation Y consistent with the GLB Act, the Board noted that section 4(k)(4) authorized financial activities, including “activities that previously have not been permissible for bank holding companies, such as acting as principal, agent, or broker for purposes of insuring, guaranteeing, or indemnifying against loss, harm, damage, illness, disability, or death, and issuing annuity products. Permissible insurance activities as principal include reinsuring insurance products. A financial holding company acting under that section may conduct insurance activities without regard to the restrictions on the insurance activities imposed on bank holding companies under section 4(c)(8).” See 65 FR 14433, 14435 (March 17, 2000).

- ***Financial, investment, and economic advisory services***

Financial, investment, and economic advisory services are financial activities specifically enumerated in section 4(k) of the BHC Act.<sup>48</sup> These activities may be provided individually or in combination and include discretionary and non-discretionary investment advisory activities. This broad authorization to provide financial, investment, or economic advisory services also includes activities that the Board previously determined were closely related to banking. For example, the Board determined that acting as an investment or financial advisor to any person was closely related to banking, including, without limitation, the activities of sponsoring, organizing, and managing a closed-end investment company, such as a hedge fund, and furnishing general economic information and advice.<sup>49</sup> The Board also previously determined that providing administrative and other services to mutual funds could be provided in connection with acting as an investment or financial advisor as activities that were closely related to banking, as described further below.

- ***Issuing or selling instruments representing interests in pools of bank-permissible assets***

Issuing or selling instruments representing interests in pools of assets permissible for a bank to hold directly is a financial activity specifically enumerated in section 4(k) of the BHC Act.<sup>50</sup>

---

<sup>48</sup> 12 U.S.C. 1843(k)(4)(C).

<sup>49</sup> See 12 CFR 225.28(b)(6) and 225.125.

<sup>50</sup> 12 U.S.C. 1843(k)(4)(D).

- ***Underwriting, dealing, and market making***

Underwriting, dealing in, or making a market in securities is a financial activity specifically enumerated in section 4(k) of the BHC Act,<sup>51</sup> which includes sponsoring and distributing all types of mutual funds and investment companies.<sup>52</sup>

- ***Merchant banking***

Section 4(k)(4)(H) of the BHC Act describes the financial activity of acquiring or controlling shares, assets or ownership interests, including debt or equity securities, in a company engaged in any activity not authorized under section 4 of the BHC Act “as part of a bona fide underwriting or merchant or investment banking activity, including investment activities engaged in for the purpose of appreciation and ultimate resale or disposition of the investment”<sup>53</sup> (“merchant banking”). Section 4(k)(4)(H) imposes several requirements on financial holding companies seeking to engage in merchant banking activities. In particular, (i) the shares may not be acquired or held by a depository institution; (ii) the shares must be acquired and held by a securities affiliate or an affiliate thereof, or in the case of a financial holding company that has an insurance company affiliate, by an affiliate that provides investment advice to an insurance company and is registered pursuant to the Investment Advisers Act of 1940, or an affiliate thereof; (iii) the shares must be held as part of a bona fide underwriting or merchant or investment banking activity, including investment activities engaged in for the purpose of appreciation and ultimate resale or disposition of the investment; (iv) the

---

<sup>51</sup> 12 U.S.C. 1843(k)(4)(E).

<sup>52</sup> See H.R. Rep. No. 106-434 at 153 (1999) (Conf. Rep.)

<sup>53</sup> 12 U.S.C. 1843(k)(4)(H).

shares are held for a period of time to enable the sale or disposition on a reasonable basis consistent with the financial viability of the company's underwriting, merchant, or investment banking activities; and (v) during the period the shares are held, the bank holding company does not routinely manage or operate the company except as may be necessary to obtain a reasonable return on investment upon resale or disposition.<sup>54</sup>

The condition in section 4(k)(4)(H) requiring that the shares only be held for a period of time to enable their sale or disposition on a reasonable basis consistent with the financial viability of the company's merchant banking activities is an essential element of a bona fide merchant banking activity. Thus, this condition is reflected in the appendix. Bona fide merchant banking activities involve investing with the intent to sell the investment at some later point in time at which a profit is expected to be realized. For example, companies such as hedge funds, mutual funds, and private equity firms<sup>55</sup> that are engaged in bona fide merchant banking activities typically make investments in companies that they believe will increase in value over time and that can be resold at a profit. Hedge funds, mutual funds, and private equity funds invest with the expectation of selling those instruments at a future date in order to realize profits consistent with a particular investment strategy rather than for the purpose of owning and operating the business.

---

<sup>54</sup> See id.

<sup>55</sup> See H.R. Rep. No. 106-434 at 154 (1999) (Conf. Rep.) (describing the merchant banking authority under section 4(k)(4)(H) as authorizing a financial holding company ("FHC") to acquire an ownership interest "in an entity engaged in any kind of trade or business whatsoever . . . whether acting as principal, on behalf of one or more entities (e.g., as adviser to a fund, regardless of whether the FHC is also an investor in the fund), including entities that the FHC controls (other than a depository institution or a subsidiary of a depository institution), or otherwise.").

The Board and the Secretary of the Treasury jointly issued regulations adopting holding periods for merchant banking investments by financial holding companies pursuant to section 4(k)(4)(H).<sup>56</sup> Specific time periods are not set forth in section 4(k) of the BHC Act. As such, they are not included in the definition of merchant banking for purposes of Title I. Nevertheless, the time periods adopted by the Board and the Secretary of the Treasury are instructive in determining whether a nonbank company is engaged in bona fide merchant banking activities. Thus, for purposes of determining whether a nonbank company is predominantly engaged in financial activities under Title I, nonbank companies that acquire and hold shares for the period permitted for financial holding companies under the Board's regulations will be presumed to be holding the shares for the purpose of appreciation and ultimate resale or disposition in accordance with the condition in section 4(k)(4)(H). This presumption will help companies determine whether they are predominantly engaged in financial activities. In addition, this presumption will reduce burden on companies that are required to report their credit exposure to significant bank holding companies and significant nonbank financial companies under section 165(d) of the Dodd-Frank Act.<sup>57</sup>

---

<sup>56</sup> See 12 CFR 225.172 and 12 CFR 1500.3, respectively.

<sup>57</sup> As previously discussed, section 165(d)(2) requires nonbank financial companies supervised by the Board and bank holding companies with total consolidated assets of \$50 billion or more to submit reports to the Board, the Council, and the FDIC on the nature and extent of (i) the company's credit exposure to other significant nonbank financial companies and significant bank holding companies; and (ii) the credit exposure of such significant entities to the company. In order to comply with this reporting obligation, companies required to report their credit exposure to significant nonbank financial companies must be able to identify those companies that are predominantly engaged in financial activities, and thus, considered to be nonbank financial companies.

The Board recognizes that some investment vehicles may hold shares for longer periods as part of a bona fide merchant banking activity consistent with the vehicle's investment strategy. For this reason, the Council, with respect to the definition of a nonbank financial company for purposes of Title I, or the Board, with respect to the definition of a significant nonbank financial company, also may determine, on a case-by-case basis, that a company that acquires and holds shares for a period of time greater than the period permissible for a financial holding company is engaged in bona fide merchant banking activities for purposes of determining whether the company is predominantly engaged in financial activities.

The prohibition in section 4(k)(4)(H) on routinely managing a portfolio company, other than for purposes of recognizing a reasonable return on resale or disposition, is an essential element of bona fide merchant banking activities. Thus, this prohibition is reflected in the appendix. As previously discussed, companies engaging in these activities purchase shares of portfolio companies to recognize an ultimate profit, rather than to engage in the underlying activity in which the portfolio company engages as its primary business activity. Routinely managing the companies, other than for the goal of recognizing a reasonable return, may indicate a strategic investment in the operations of another firm.

Section 4(k) does not define the statutory prohibition of routinely managing a portfolio company. The regulations issued by the Board and the Secretary of the Treasury governing the merchant banking activities of financial holding companies provide guidance on the statutory prohibition of routinely managing a portfolio company in connection with a bona fide merchant banking activity. These regulations are

instructive in determining whether a nonbank company is engaged in bona fide merchant banking activities. Therefore, for purposes of determining whether a nonbank company is predominantly engaged in financial activities under Title I, nonbank companies that comply with this guidance regarding the limitations on managing or operating a portfolio company will be presumed to be engaged in a bona fide merchant banking activity. This presumption will reduce burden on companies attempting to determine whether they, or certain of their counterparties,<sup>58</sup> are predominantly engaged in financial activities. The Council or the Board, as appropriate, also may determine, on a case-by-case basis, that an entity that does not comply with the Board's guidance regarding this limitation may still be engaged in a bona fide merchant banking activity for purposes of determining whether the company is predominantly engaged in financial activities.

By contrast, the condition in section 4(k)(4)(H) requiring a financial holding company engaging in merchant banking activities to have a securities affiliate is not an essential element of bona fide merchant banking activities for determining whether these activities are financial activities.<sup>59</sup> This is evidenced by the fact that section 4(k) does not require that the securities affiliate participate in or play a role with respect to these

---

<sup>58</sup> See id.

<sup>59</sup> The legislative history related to Congress's authorization of "underwriting, merchant, and investment banking activities" distinguishes between the activities themselves and certain conditions imposed on the conduct of these activities by a financial holding company that do not define the activities, such as the requirement that a financial holding company have a securities affiliate. See Conf. Rep. 106-434, 154 (November 2, 1999). ("The authorization of merchant banking activities as provided in new section 4(k)(4)(H) of the BHCA is designed to recognize the essential role *that these activities* play in modern finance and permits an FHC that has a securities affiliate or an affiliate of an insurance company engaged in underwriting life, accident and health, or property and casualty insurance, or providing and issuing annuities, *to conduct such activities.*") (emphasis added).

activities. This condition was designed to ensure that only those financial holding companies with experience engaging in investment, securities, or advisory activities conducted merchant banking activities. Accordingly, this condition is not reflected in the appendix.

Similarly, the condition in section 4(k)(4)(H) requiring that shares acquired as part of a bona fide merchant banking activity not be acquired or held by a depository institution is not an essential element of such activities, and thus is not reflected in the appendix. This restriction was imposed because banks are restricted from investing in certain types of companies by statute and regulation, and in particular, national banks were prohibited by the GLB Act from engaging in merchant banking activities through a financial subsidiary unless certain findings were made by the Secretary of the Treasury and the Board.<sup>60</sup> The restriction on acquiring or holding investments through a depository institution does not define the activity of merchant banking but rather imposes conditions on holding the investment through one type of corporate affiliate. The condition does not define the activity itself, as financial holding companies, which have bank affiliates, engage in these activities on a regular basis.

Finally, section 4(k)(4)(H) provides that shares acquired in connection with a bona fide merchant banking activity must be those of a company engaged in an activity not authorized under section 4 of the BHC Act. This provision provided new authority for bank holding companies that qualify as financial holding companies to engage in merchant banking activities with regard to nonbanking firms; bank holding companies

---

<sup>60</sup> See, e.g., 12 U.S.C. 24, (Seventh); 12 U.S.C. 24, (Eleventh); 12 CFR 1.



were already authorized under other provisions of section 4 of the BHC Act to invest in firms engaged in financial activities.<sup>61</sup> For this reason, the Board has retained this reference to an “activity not authorized under section 4 of the BHC Act” in the description of bona fide merchant banking activities. An investment in a company engaged in activities otherwise permissible under section 4 would otherwise be treated as a financial activity under section 4(k)(1) or other provisions of section 4(k). Thus, shares acquired in all types of firms in connection with a bona fide merchant banking activity are effectively included by section 4(k) within the list of permissible financial activities.

- ***Insurance Company Portfolio Investments***

Section 4(k)(4)(I) of the BHC Act authorizes companies engaged in certain types of insurance activities to make portfolio investments. In particular, financial holding companies are authorized to acquire assets or ownership interests, including debt or equity securities, of a company or other entity engaged in any activity not authorized by section 4(k) if: (i) the shares, assets, or ownership interests are not acquired or held by a depository institution or a subsidiary of a depository institution; (ii) such shares, assets, or ownership interests are acquired and held by an insurance company that is predominantly engaged in underwriting life, accident and health, or property and casualty insurance (other than credit-related insurance) or providing and issuing annuities; (iii) such shares, assets, or ownership interests represent an investment made in the ordinary course of

---

<sup>61</sup> See 65 FR 16460, 16463-16464 (March 28, 2000), in which the Board noted that the provision in section 4(k)(4)(H) that authorizes a financial holding company to invest in any company engaged in any activity not authorized pursuant to section 4 of the BHC Act “appears to have been included in recognition of the fact that other provisions of the BHC Act permit a financial holding company to make investments in companies that conduct financial activities without resorting to merchant banking authority.”

business of such insurance company in accordance with relevant state law governing such investments; and (iv) during the period such shares, assets, or ownership interests are held, the bank holding company does not routinely manage or operate such company except as may be necessary or required to obtain a reasonable return on investment.<sup>62</sup>

The conditions in section 4(k)(4)(I) requiring that the shares (i) be acquired and held by an insurance company engaged in particular activities, (ii) in the ordinary course of business of the acquiring insurance company in accordance with relevant state law governing such investments, are essential elements of this activity, which was authorized by Congress specifically to permit “an insurance company that is affiliated with a depository institution to continue to directly or indirectly acquire or control any kind of ownership interest in any company,” in recognition of the fact “that as part of the ordinary course of business, insurance companies frequently invest funds received from policyholders by acquiring most or all the shares of stock of a company that may not be engaged in a financial activity.”<sup>63</sup> Thus, these conditions are reflected in the appendix. In contrast to merchant banking activities described in section 4(k)(4)(H), which requires a financial holding company engaging in such activities to have a securities affiliate, but does not require that the securities affiliate play a role in the activities, section 4(k)(4)(I) requires that the investment activities authorized thereunder be conducted *by or through an insurance company*.

---

<sup>62</sup> 12 U.S.C. 1843(k)(4)(I).

<sup>63</sup> See H.R. Rep. No. 106-434 at 154 (1999) (Conf. Rep.) (further describing section 4(k)(4)(I) as recognizing that “these investments are made in the ordinary course of business pursuant to state insurance laws governing investments by insurance companies, and are subject to ongoing review and approval by the applicable state regulator”).

The prohibition in section 4(k)(4)(I) on routinely managing a portfolio company, other than for purposes of recognizing a reasonable return on the investment, is an essential element of the investment activities conducted by insurance companies. Thus, this prohibition is reflected in the appendix. As noted previously, insurance companies typically invest policyholder funds in other companies in the ordinary course of business pursuant to state insurance laws. Routinely managing the companies, other than for the purpose of recognizing a return on investment, may indicate a strategic investment in the operations of the other company.<sup>64</sup>

Section 4(k)(4)(I) requires that shares acquired pursuant to an insurance company's investment activities not be acquired or held by a depository institution. This condition is not an essential element of this activity, and, thus, is not reflected in the appendix. The restriction on acquiring or holding investments through a depository institution does not define the investment activity described in section 4(k)(4)(I), but rather imposes conditions on holding the investment through one type of corporate affiliate. As discussed previously, section 4(k)(4)(I) requires that the investment activities authorized thereunder be conducted by or through an insurance company. In addition, as noted previously, banks are restricted from investing in certain types of companies by statute and regulation.<sup>65</sup> The condition does not define the activity itself,

---

<sup>64</sup> See *id.* at 155 (noting that “to the extent an FHC participates in the management or operation of a portfolio company, such participation would ordinarily be for the purpose of safeguarding the investment of the insurance company in accordance with applicable state insurance law. This is irrespective of any overlap between board members and officers of the FHC and the portfolio company”).

<sup>65</sup> See, e.g., 12 U.S.C. 24, (Seventh); 12 U.S.C. 24, (Eleventh); 12 CFR 1.

as insurance companies affiliated with depository institutions engage in these activities on a regular basis.<sup>66</sup>

Finally, as in section 4(k)(4)(H), section 4(k)(4)(I) provides that shares acquired by an insurance company in connection with its investment activities must be those of a company engaged in an activity not authorized under section 4 of the BHC Act. For the same reasons described above, the Board has retained this reference to an “activity not authorized under section 4 of the BHC Act” in the description of the investment activities of insurance companies pursuant to section 4(k)(4)(I). An investment in a company engaged in activities otherwise permissible under section 4 would otherwise be treated as a financial activity under section 4(k)(1) or other provisions of section 4(k). Thus, investments by insurance companies in all types of firms are effectively included by section 4(k) within the list of permissible financial activities.

- ***Lending, exchanging, transferring, investing for others, safeguarding financial assets other than money or securities, and other activities***

The activities of lending, exchanging, transferring, investing for others, or safeguarding financial assets other than money or securities; providing any device or other instrumentality for transferring money or other financial assets; and arranging, effecting, or facilitating financial transactions for the account of third parties are financial activities specifically enumerated in section 4(k)(5) of the BHC Act.<sup>67</sup>

---

<sup>66</sup> As discussed above, section 4(k)(4)(I) was intended to permit “an insurance company that is affiliated with a depository institution to continue to directly or indirectly acquire or control any kind of ownership interest in any company if certain requirements are met.” See H.R. Rep. No. 106-434 at 154 (1999) (Conf. Rep.).

<sup>67</sup> 12 U.S.C. 1843(k)(5). The BHC Act requires the Board to define the extent to which these activities are financial in nature or incidental thereto. The Board and the Secretary

## **ii. Financial activities that are closely related to banking**

Section 4(k) provides that “any activity that the Board has determined to be so closely related to banking or managing or controlling banks as to be a proper incident thereto” is a financial activity.<sup>68</sup> These activities are also financial for purposes of determining whether a firm is predominantly engaged in financial activities under Title I. These activities include the following:

- ***Extending credit and servicing loans***

Making, acquiring, brokering, or servicing loans or other extensions of credit (including factoring, issuing letters of credit and accepting drafts) for the company’s account or for the account of others were authorized by the Board as activities that are closely related to banking.<sup>69</sup>

- ***Activities related to extending credit***

Activities usual in connection with making, acquiring, brokering, or servicing loans or other extensions of credit were authorized by the Board as activities that are closely related to banking.<sup>70</sup> These activities include performing appraisals of real estate and personal property (including securities), acting as an intermediary for commercial or industrial real estate financing, providing check guarantee, collection agency, and credit

---

of the Treasury issued a joint interim rule authorizing such activities as permissible for financial holding companies. See 66 FR 257 (January 3, 2001).

<sup>68</sup> 12 U.S.C. 1843(k)(4)(F).

<sup>69</sup> 12 U.S.C. 1843(k)(4)(F); 12 CFR 225.28(b)(1). See 62 FR 9290, 9305 (February 28, 1997), in which the Board noted that “[l]ending activities are already broadly defined and contain no restrictions.”

<sup>70</sup> 12 U.S.C. 1843(k)(4)(F); 12 CFR 225.28(b)(2).

bureau services, engaging in asset management, servicing, and collection activities, acquiring debt in default, and providing real estate settlement services.<sup>71</sup>

The Board's regulations impose certain conditions on the conduct of these activities that are not relevant for determining whether these activities are considered financial for purposes of determining whether a firm is predominantly engaged in financial activities. For instance, under the Board's regulations, a bank holding company that is arranging financing for commercial or industrial income-producing real estate may not have an interest in, participate in managing or developing, or promote or sponsor the development of a property for which it is arranging financing, or engage in property management or real estate brokerage.<sup>72</sup> These conditions were imposed to clarify that real property management and real estate brokerage activities—which were not at the time found to be financial activities—are not indirectly authorized as permissible for bank holding companies through the activity of real estate financing.<sup>73</sup> As such, the appendix reflects the activity of arranging commercial real estate financing without reference to the independent activities of owning, managing, developing, or promoting or

---

<sup>71</sup> Id.

<sup>72</sup> 12 U.S.C. 1843(k)(4)(F); 12 CFR 225.28(b)(2)(ii).

<sup>73</sup> The Board first approved the application of a bank holding company to engage in real estate equity financing in 1982. In approving this activity, the Board noted that it had imposed conditions, including that the bank holding company not have an interest in, participate in managing or developing, or promote or sponsor the development of a property for which it is arranging financing, “to confine the activity . . . to equity financing and to prevent [the bank holding company] from engaging in real estate development . . .” See BankAmerica Corporation, 68 Federal Reserve Bulletin 647 (1982). The activity of arranging commercial real estate equity financing was added to Regulation Y in 1984 and incorporated the limitations that the Board had placed on the activity in the 1982 order. See 70 Federal Reserve Bulletin 121, 137 (1984).

sponsoring development of real estate.<sup>74</sup> While neither real estate brokerage nor real estate management are financial activities under section 4(k), a company may engage in these activities and still be predominantly engaged in the financial activity of arranging commercial real estate financing. Under the final rule, only assets and revenues associated with this latter activity are considered financial for purposes of determining whether a firm is predominantly engaged in financial activities.

Acquiring debt in default also is a financial activity for purposes of determining whether a firm is predominantly engaged in financial activities under Title I as it is an activity that is usual in connection with making, acquiring, brokering, or servicing loans or other extensions of credit.<sup>75</sup> Under the Board's regulations, a bank holding company that acquires debt in default must divest assets securing the debt that are impermissible for bank holding companies to hold within a certain time period, stand only in the position of a creditor, not purchase equity of obligors of debt in default, and not acquire debt in default secured by shares of a bank or bank holding company. These conditions are intended to prevent bank holding companies from circumventing the BHC Act and other provisions of law. For instance, the condition requiring a bank holding company to divest impermissible assets within a certain timeframe was intended to distinguish between a bank holding company's acquisition of debt in default and its retention of impermissible collateral securing the debt.<sup>76</sup> The conditions requiring the bank holding company to stand only in the position of a creditor and not purchase equity of obligors of

---

<sup>74</sup> Neither real estate brokerage nor real estate management is an activity that is financial in nature. See 12 U.S.C. 1843 note; Pub. Law 111-8, sec. 624 (Mar. 11, 2009).

<sup>75</sup> 12 CFR 225.28(b)(2)(vii).

<sup>76</sup> See 62 FR 9290, 9305 (February 28, 1997).

debt in default are intended to prevent a bank holding company from acquiring assets in connection with a debt previously contracted the ownership of which is prohibited by the BHC Act or other provisions of law. These conditions are not related to defining the financial nature of the activity of acquiring debt in default.<sup>77</sup> The condition requiring that the debt not be secured by shares of a bank or bank holding company was imposed to prevent the bank holding company from circumventing the BHC Act's requirement that a bank holding company obtain approval from the Board before acquiring control of another bank or bank holding company.<sup>78</sup> For these reasons, these conditions are not relevant for determining whether the assets and revenues associated with these activities are considered financial for purposes of determining whether a firm is predominantly engaged in financial activities. The appendix provides that the activity of acquiring debt that is in default at the time of acquisition is a financial activity for purposes of determining whether a company is predominantly engaged in financial activities under Title I without reference to these conditions.

- *Leasing*

Leasing personal or real property, and acting as an agent, broker, or adviser for leasing personal or real property were determined to be closely related to banking by the Board.<sup>79</sup> Under the Board's regulations, permissible leasing must involve a lease that is on a nonoperating basis with an initial term of at least 90 days. In addition, leasing involving real property must have the effect of yielding a return that will compensate the

---

<sup>77</sup> Id.

<sup>78</sup> Id.

<sup>79</sup> 12 U.S.C. 1843(k)(4)(F); 12 CFR 225.28(b)(3).



lessor for not less than the lessor's full investment plus the estimated cost of financing the property over the term of the lease, and the property must have an estimated residual value that is no more than 25 percent of the acquisition cost of the property. The conditions serve to distinguish between the financial activity of leasing and the nonfinancial activities of real or personal property rental and real estate management.<sup>80</sup> As such, the appendix reflects these conditions in defining the activities of leasing and acting as an agent, broker, or adviser for personal or real property.

- ***Operating nonbank depository institutions***

The activity of owning, controlling, and operating depository institutions, including industrial banks, Morris Plan banks, industrial loan companies and savings associations that do not qualify as "banks" for purposes of the BHC Act was determined to be closely related to banking by the Board.<sup>81</sup> While the Board's regulations require that a thrift owned, controlled, or operated by a bank holding company be engaged only in deposit-taking activities and activities permissible for bank holding companies, the appendix does not include these conditions because they are inconsistent with section 102 of the Dodd-Frank Act, which provides that all revenues from or assets related to the ownership of an insured depository institution shall be considered to be financial.

---

<sup>80</sup> See 62 FR 9290, 9306 (February 28, 1997) ("These requirements were developed in the course of litigation regarding the leasing activities of national banks, and were relied on by the courts in distinguishing bank leasing activities from general property rental and real estate development businesses. The requirement that a lease be nonoperating is also a statutory requirement limiting the high residual value leasing activities of national banks.")

<sup>81</sup> 12 U.S.C. 1843(k)(4)(F); 12 CFR 225.28(b)(4).

- ***Trust company functions***

The activities performed by a trust company (including activities of a fiduciary, agency, or custodial nature) that is not a bank for purposes of section 2(c) of the BHC Act were determined to be closely related to banking by the Board.<sup>82</sup>

- ***Financial and investment advisory activities***

Acting as an investment or financial advisor to any person was determined to be closely related to banking by the Board.<sup>83</sup> The activity includes, without limitation, serving as a registered investment adviser to a registered investment company, including sponsoring, organizing, and managing a closed-end investment company; furnishing general economic information and advice, general economic statistical forecasting services, and industry studies; providing advice in connection with mergers, acquisitions, divestitures, investments, joint ventures, leveraged buyouts, recapitalizations, capital structurings, financing transactions and similar transactions; and conducting financial feasibility studies; providing information, statistical forecasting, and advice with respect to any transaction in foreign exchange, swaps, and similar transactions, commodities, and any forward contract, option, future, option on a future, and similar instruments; providing educational courses and instructional materials to consumers on individual financial management matters; and providing tax-planning and tax-preparation services to any person.<sup>84</sup>

---

<sup>82</sup> 12 U.S.C. 1843(k)(4)(F); 12 CFR 225.28(b)(5).

<sup>83</sup> 12 U.S.C. 1843(k)(4)(F); 12 CFR 225.28(b)(6).

<sup>84</sup> Id.

- *Agency transactional services for customer investments*

Providing agency transactional services, including providing securities brokerage services, acting as a riskless principal, providing private placement services, and acting as a futures commission merchant were determined to be closely related to banking by the Board.<sup>85</sup>

Regulation Y imposes conditions on the manner in which bank holding companies may conduct securities brokerage services, act as riskless principal, provide private placement services, and act as a futures commission merchant. For instance, bank holding companies providing securities brokerage services under this authority are limited to buying and selling securities solely as agent for the account of customers and may not conduct securities underwriting or dealing activities. Bank holding companies providing private placement services under this authority may not purchase or repurchase for their own account the securities being placed or hold in inventory unsold portions of issues of those securities. Bank holding companies acting as riskless principal under this authority are subject to conditions with respect to bank-ineligible securities.

Each of these conditions was intended to prevent a bank holding company from engaging in securities underwriting or dealing activities in connection with the activities of securities brokerage, private placement, or riskless principal, which were impermissible for bank holding companies under the Glass-Steagall Act at the time the activities were authorized.<sup>86</sup> The fact that a firm may retain some portion of shares in connection with, for example, private placement activities, does not affect or negate the

---

<sup>85</sup> 12 U.S.C. 1843(k)(4)(F); 12 CFR 225.28(b)(7).

<sup>86</sup> See 62 FR 9290, 9307-9308 (February 28, 1997).

financial nature of private placement activities. Moreover, as described elsewhere, securities underwriting and dealing activities were subsequently determined by statute to be financial activities. Thus, the appendix provides that the following activities are financial without the non-definitional conditions:

- Providing securities brokerage services (including securities clearing and/or securities execution services on an exchange), whether alone or in combination with investment advisory services, and incidental activities (including related securities credit activities and custodial services).
- Buying and selling in the secondary market all types of securities on the order of customers as a “riskless principal” in a transaction in which the company purchases (or sells) the security for its own account to offset a contemporaneous sale to (or purchase from) the customer.
- Acting as agent for the private placement of securities in accordance with the requirements of the Securities Act of 1933 (1933 Act) and the rules of the Securities and Exchange Commission.

Under the Board’s regulations, a bank holding company acting as a futures commission merchant must conduct the activity through a separately incorporated subsidiary, the contract must be traded on an exchange, and the parent bank holding company may not guarantee that subsidiary’s liabilities. The appendix does not reflect these conditions, as they were imposed for the prudential purpose of limiting the transmission of risk from these activities to an insured depository affiliate or the parent bank holding company.<sup>87</sup>

---

<sup>87</sup> *Id.* at 9309. (“The Board has determined that a . . . restriction that prohibits the parent bank holding company from guaranteeing or otherwise becoming liable for non-proprietary trades conducted by or through its FCM subsidiary . . . effectively addresses the Board’s concern about a parent bank holding company’s exposure to an exchange’s or clearinghouse’s loss sharing rules . . . [by protecting] the parent bank holding company from potential exposure from customer trades and open-ended contingent liability under loss sharing rules . . .”).

The Board's regulations also contain a broad provision authorizing a bank holding company to provide "transactional services for customers involving any derivative or foreign exchange transaction that a bank holding company is permitted to conduct for its own account."<sup>88</sup> Specifically, the Board's Regulation Y describes the activity as "[p]roviding to customers as agent transactional services with respect to swaps and similar transactions, any transaction described in paragraph (b)(8) of this section, any transaction that is permissible for a state member bank, and any other transaction involving a forward contract, option, futures, option on a futures or similar contract (whether traded on an exchange or not) relating to a commodity that is traded on an exchange."<sup>89</sup> In the Second NPR, the Board proposed removing the requirement that agent transactional services on certain commodity derivatives transactions be provided only with respect to a commodity that is traded on an exchange (regardless of whether the contract being traded is traded on an exchange) because the limitation was imposed for safety and soundness reasons. In light of comments received, the Board has determined that this condition, while serving a prudential role, also is part of the definition of the authorized activity because it prevents a bank holding company from engaging in the forward sale of commercial products. Because the condition distinguishes the financial

---

<sup>88</sup> Id. at 9310.

<sup>89</sup> 12 CFR 225.28(b)(7)(v). The 1997 rulemaking describes this financial activity as permitting a bank holding company to "...act as a broker with respect to forward contracts based on a financial or nonfinancial commodity that also serves as the basis for an exchange-traded futures contract. This permits a bank holding company to act as agent in a forward contract that involves the same commodities and assessment of risk that underlay the permissible FCM activities of bank holding companies without extending this authority to forward contracts for the delayed sale of commercial products (such as automobiles, consumer products, etc.) or real estate." See 62 FR 9290, 9311 (February 28, 1997).

activity of engaging in derivatives contracts from the commercial sale of assets, the final appendix includes this condition.

- ***Investment transactions as principal***

Engaging in investment transactions as principal, including underwriting and dealing in government obligations and money market instruments, investing and trading as principal in foreign exchange and derivatives, and buying and selling bullion were determined to be closely related to banking by the Board.<sup>90</sup> Under the Board's regulations, bank holding companies engaged in underwriting and dealing in government obligations and money market instruments are subject to the same limitations as would be applicable if the activity were performed by member banks.<sup>91</sup> The appendix does not reflect this limitation because it was intended to prevent circumvention of the Glass-Steagall Act. This condition does not define the activity of engaging in investment transactions as principal and is therefore not relevant for determining whether the activity of underwriting and dealing in government obligations and money market instruments is financial for purposes of determining whether a firm is predominantly engaged in financial activities.<sup>92</sup>

Under the Board's regulations, engaging in derivatives transactions is a financial activity provided that the derivative contract is not a bank-ineligible security, and either

---

<sup>90</sup> 12 U.S.C. 1843(k)(4)(F); 12 CFR 225.28(b)(8).

<sup>91</sup> 12 CFR 225.28(b)(8)(i).

<sup>92</sup> 62 FR 9290, 9311 (February 28, 1997).

the asset underlying the contract is a bank permissible asset or the contract contains conditions designed to limit the potential that physical settlement would occur.<sup>93</sup>

In the Second NPR, the Board proposed to remove these conditions in defining derivatives activities that are financial activities. Commenters expressed the view that the conditions requiring cash-settlement were necessary to distinguish between commercial activities involving physically settled derivatives contracts and the types of financial derivative activities conducted by financial companies.

The Board has considered these comments, as well as the Board's other precedents, in evaluating whether the conditions relating to cash-settlement and assignment or offset are an essential part of the definition of the financial activity of engaging in derivatives activities. These conditions were imposed by the Board originally to reduce the potential that bank holding companies would become involved in and bear the risks of physical possession, transport, storage, and delivery of commodities and to ensure that the commodity derivatives business of a bank holding company is largely limited to acting as a financial intermediary in the facilitation of transactions for customers who use or produce commodities or are otherwise exposed to commodity price risk as part of their regular business.<sup>94</sup> In certain instances, the Board has determined that engaging in physically-settling commodities, physical commodity trading, energy tolling, and energy management services, are activities that are complementary to the financial

---

<sup>93</sup> 12 CFR 225.28(b)(8)(ii)(B).

<sup>94</sup> See 68 FR 39807, 39808 (July 3, 2003).

activity of engaging as principal in commodity derivatives transactions.<sup>95</sup> Under section 4(k) of the BHC Act, complementary activities are those that, although not necessarily financial in nature, are so meaningfully connected to financial activities that they complement those financial activities.

Based on this review, the Board has determined that these conditions, while serving an important prudential role, are also part of the definition of the authorized activity because they distinguish these derivatives activities from similar derivatives activities that are not conducted as a financial intermediary. Thus, the appendix includes, as a financial activity for purposes of Title I, engaging as principal in forward contracts, options, futures, options on futures, swaps, and similar contracts, whether traded on exchanges or not, based on any rate, price, financial asset (including gold, silver, platinum, palladium, copper, or any other metal), nonfinancial asset, or group of assets, other than a bank-ineligible security<sup>96</sup> if: (i) a state member bank is authorized to invest in the asset underlying the contract;<sup>97</sup> (ii) the contract requires cash settlement; (iii) the contract allows for assignment, termination, or offset prior to delivery or expiration, and

---

<sup>95</sup> See Board letters regarding Bank of America Corporation (April 24, 2007), Credit Suisse Group (March 27, 2007), Fortis S.A./N.V. (September 29, 2006), and Wachovia Corporation (April 13, 2006); and Board orders regarding Royal Bank of Scotland Group plc, 94 Federal Reserve Bulletin C60 (2008), Societe Generale, 92 Federal Reserve Bulletin C113 (2006), Deutsche Bank AG, 91 Federal Reserve Bulletin C54 (2005), JPMorgan Chase & Co., 91 Federal Reserve Bulletin C57 (2005); Barclays Bank PLC, 90 Federal Reserve Bulletin 511 (2004), UBS AG, 90 Federal Reserve Bulletin 215 (2004), and Citigroup Inc., 89 Federal Reserve Bulletin 508 (2003).

<sup>96</sup> The Board's Regulation Y provides that a bank-ineligible security is any security that a state member bank is not permitted to underwrite or deal in under 12 U.S.C. 24 and 335.

<sup>97</sup> State member banks may own, for example, investment grade corporate debt securities, U.S. government and municipal securities, foreign exchange, and certain precious metals. See 68 FR 39807, 39808, note 2 (July 3, 2003).



the company makes every reasonable effort to avoid taking or making delivery of the asset underlying the contract, or receives and instantaneously transfers title to the underlying asset, by operation of contract and without taking or making physical delivery of the asset; or (iv) the contract does not allow for assignment, termination, or offset prior to delivery or expiration and is based on an asset for which futures contracts or options on futures contracts have been approved for trading on a U.S. contract market by the Commodity Futures Trading Commission, and the company makes every reasonable effort to avoid taking or making delivery of the asset underlying the contract, or receives and instantaneously transfers title to the underlying asset, by operation of contract and without taking or making physical delivery of the asset.

Similarly, engaging as principal in forward contracts, options, futures, options on futures, swaps, and similar contracts, whether traded on exchanges or not, based on an *index* of a rate, a price, or the value of any financial asset, nonfinancial asset, or group of assets, is a financial activity *only if* the contract requires cash settlement.

Investing and trading in foreign exchange is a financial activity under the Board's regulations.

The Board also received a comment in response to the Second NPR requesting that the Board clarify that derivatives transactions would not be considered "financial" with respect to a commercial manufacturer, producer, shipper, energy, or commodity firm when they are incidental or ancillary to a party's activities as such. Under the Dodd-Frank Act, whether an activity is "financial" is determined by the nature of the activity, rather than by what type of firm conducts the activity. Thus, the Board did not amend the appendix to the final rule in this manner.

- ***Management consulting and counseling activities***

The Board has authorized management consulting as a permissible activity under several different authorities, each of which are encompassed within the cross-references contained in section 4(k) of the BHC Act. Providing management consulting advice on any matter to unaffiliated depository institutions and on any financial, economic, accounting, or audit matter to any other company (“financial management consulting services”) was determined to be closely related to banking by the Board.<sup>98</sup> Under the Board’s regulations, bank holding companies that engage in financial management consulting services also are permitted to provide management consulting services generally to any company *other than an unaffiliated depository institution, on any non-financial matter* (“non-financial management consulting services”), provided at least 70 percent of the bank holding company’s total annual revenue derived from all management consulting services is derived from financial management consulting services. The revenue limitation on providing non-financial management consulting services was designed to limit the involvement of bank holding companies in the provision of management consulting services on non-financial matters to nondepository

---

<sup>98</sup> 12 U.S.C. 1843(k)(4)(F); 12 CFR 225.28(b)(9)(i). The Board’s regulations provide that in conducting management consulting advice, bank holding companies are not authorized to perform tasks or operations or provide services to client institutions either on a daily or continuing basis, except as necessary to instruct the client institution on how to perform such services for itself. This restriction was designed to limit a bank holding company’s activities to providing advice rather than other services that may involve impermissible activities for bank holding companies. For purposes of Title I, assets and revenues derived from providing management consulting services to a depository institution and any consulting on financial, economic, accounting, or audit matters to any company, will be considered financial regardless of other services the firm might provide. See 12 CFR 225.28(b)(9)(i), note 11.

institutions. The limitations on the authority of bank holding companies to provide non-financial management consulting services does not change the nature of the permissible financial management consulting services done within those limits.

For purposes of applying the asset and revenue tests under Title I, assets and revenues derived from or associated with any management consulting services to a depository institution and any consulting on financial, economic, accounting, or audit matters to any company, will be considered financial. In addition, because a bank holding company may derive up to 30 percent of its total annual revenue from non-financial management consulting services and still be considered to be engaged in financial management consulting activities under the Board's regulations, for purposes of the applying the asset and revenue tests under Title I, up to 30 percent of a nonbank company's assets or revenues related to non-financial management consulting services will be included in the company's financial assets or revenues.

The Board's regulations also prohibit a bank holding company providing financial management consulting services from owning or controlling more than 5 percent of the voting securities of a client institution or from having a management interlock.<sup>99</sup> These conditions were intended to ensure that a bank holding company does not effectively exercise control over a client company with which it has a management consulting contract, thereby circumventing the prohibitions and notice requirements applicable to bank holding companies seeking to acquire a controlling interest in a company engaged

---

<sup>99</sup> See *id.* See also 62 FR 9290, 9304, 9312 (February 28, 1997).

in nonbanking activities, and to prevent conflicts of interest.<sup>100</sup> However, the Board believes that these conditions also serve a definitional role to distinguish management consulting from the actual conduct of the commercial activity in which a client firm is engaged.

The authorization for these activities overlaps with, and is largely subsumed under, the broader authority to engage in management consulting services that was determined to be usual in connection with banking abroad, described below. Therefore, a company that engages in management consulting activities in a manner that does not comply with the conditions described above will be considered to be engaged in a financial activity if its management consulting activities are captured by the broader authority.

Providing employee benefits consulting services to employee benefit, compensation and insurance plans, including designing plans, assisting in the implementation of plans, providing administrative services to plans, and developing employee communication programs for plans was determined to be closely related to banking by the Board.<sup>101</sup> Providing career counseling services also was determined to be closely related to banking by the Board,<sup>102</sup> subject to the condition that the services must be provided to a financial organization and individuals currently employed by, or recently displaced from, a financial organization; to individuals who are seeking employment at a financial organization; or to individuals currently employed in or who are seeking

---

<sup>100</sup> See 62 FR 9290, 9304, 9312 (February 28, 1997).

<sup>101</sup> 12 U.S.C. 1843(k)(4)(F); 12 CFR 225.28(b)(9)(ii).

<sup>102</sup> 12 U.S.C. 1843(k)(4)(F); 12 CFR 225.28(b)(9)(iii).

positions in the finance, accounting, and audit departments of any company. These conditions are essential to this activity's being considered financial, and thus, this activity is included in the appendix with these conditions.

- ***Courier services and printing and selling MICR-encoded items***

The activity of providing courier services for: (i) checks, commercial papers, documents, and written instruments (excluding currency or bearer-type negotiable instruments) that are exchanged among banks and financial institutions, and (ii) audit and accounting media of a banking or financial nature and other business records and documents used in processing such media was determined to be closely related to banking by the Board.<sup>103</sup>

The activity of printing and selling checks and related documents, including corporate image checks, cash tickets, voucher checks, deposit slips, savings withdrawal packages, and other forms that require Magnetic Ink Character Recognition encoding also was determined to be closely related to banking by the Board.<sup>104</sup>

- ***Insurance agency and underwriting***

Certain insurance activities, including activities related to the provision of credit insurance and insurance in small towns, were determined to be closely related to banking by the Board.<sup>105</sup> Under the Board's regulations, bank holding companies may engage in these activities, subject to various conditions and limitations, which are reflected in the appendix. However, the authorization for these activities overlaps with, and is largely

---

<sup>103</sup> 12 U.S.C. 1843(k)(4)(F); 12 CFR 225.28(b)(10)(i).

<sup>104</sup> 12 U.S.C. 1843(k)(4)(F); 12 CFR 225.28(b)(10)(ii).

<sup>105</sup> 12 U.S.C. 1843(k)(4)(F); 12 CFR 225.28(b)(11).

subsumed under, the general authority to engage in insurance underwriting and insurance agency activities discussed above. Therefore, a company that engages in insurance activities in a manner that does not comply with the conditions described above will be considered to be engaged in a financial activity if its insurance activities are captured by the general authority.

- ***Community development activities***

The activities of making debt and equity investments in corporations or projects that are designed primarily to promote community welfare, and providing advisory and related services for such programs was determined to be closely related to banking by the Board.<sup>106</sup>

- ***Money orders, savings bonds, and traveler's checks***

Issuing and selling money orders and similar consumer-type payment instruments, selling U.S. savings bonds, and issuing traveler's checks were determined to be closely related to banking by the Board.<sup>107</sup>

- ***Data processing***

Providing data processing services and related activities with respect to financial, banking, or economic data was determined to be closely related to banking by the Board.<sup>108</sup> Under the Board's regulations, a bank holding company's data processing activities must comply with the conditions that the hardware provided in connection with these services be offered only in conjunction with software related to the processing,

---

<sup>106</sup> 12 U.S.C. 1843(k)(4)(F); 12 CFR 225.28(b)(12).

<sup>107</sup> 12 U.S.C. 1843(k)(4)(F); 12 CFR 225.28(b)(13).

<sup>108</sup> 12 U.S.C. 1843(k)(4)(F); 12 CFR 225.28(b)(14).

storage, and transmission of financial, banking, or economic data, and all general purpose hardware provided with financial software not constitute more than 30 percent of the cost of any packaged offering.

The restrictions on providing hardware as part of providing financial data processing services were designed to limit the involvement of bank holding companies in the sale of data processing hardware, in particular, the sale of general purpose hardware. The limitations on the authority of bank holding companies to provide hardware as part of financial data processing do not change the nature of the permissible financial data processing done within those limits. For purposes of applying the asset and revenue tests under Title I, only that portion of a firm's data processing that involves providing financial data processing along with related hardware up to the limits imposed on bank holding companies would be considered financial activities. The provision of hardware or nonfinancial data processing beyond those limits would not disqualify the financial data processing revenues or assets, but also would not be considered financial activities.

- ***Mutual fund administrative services***

Providing administrative and other services to mutual funds was determined be closely related to banking by the Board.<sup>109</sup>

- ***Owning shares of a securities exchange***

Owning shares of a securities exchange was determined to be closely related to banking by the Board.<sup>110</sup>

---

<sup>109</sup> 12 U.S.C. 1843(k)(4)(F); 12 CFR 225.86(a)(2)(i).

<sup>110</sup> 12 U.S.C. 1843(k)(4)(F); 12 CFR 225.86(a)(2)(ii).

- ***Certification services***

Acting as a certification authority for digital signatures and authenticating the identity of persons conducting financial and nonfinancial transactions was determined to be closely related to banking by the Board.<sup>111</sup>

- ***Providing employment histories***

Providing employment histories to third parties for use in making credit decisions and to depository institutions and their affiliates for use in the ordinary course of business was determined to be closely related to banking by the Board.<sup>112</sup>

- ***Check-cashing and wire-transmission services***

Providing check-cashing and wire-transmission services was determined to be closely related to banking by the Board.<sup>113</sup>

- ***Postage, vehicle registration, public transportation services***

The activities of providing notary-public services, selling postage stamps and postage-paid envelopes, providing vehicle registration services, and selling public-transportation tickets and tokens, when offered in connection with banking services, were determined to be closely related to banking by the Board.<sup>114</sup>

---

<sup>111</sup> 12 U.S.C. 1843(k)(4)(F); 12 CFR 225.86(a)(2)(iii).

<sup>112</sup> 12 U.S.C. 1843(k)(4)(F); 12 CFR 225.86(a)(2)(iv).

<sup>113</sup> 12 U.S.C. 1843(k)(4)(F); 12 CFR 225.86(a)(2)(v).

<sup>114</sup> 12 U.S.C. 1843(k)(4)(F); 12 CFR 225.86(a)(2)(vi).



- ***Real estate title abstracting***

Engaging in real estate title abstracting was determined to be closely related to banking by the Board.<sup>115</sup>

**iii. Financial activities that are usual in connection with banking or other financial operations abroad**

Section 4(k) defines as a financial activity “engaging, in the United States, in any activity that: (i) a bank holding company may engage in outside of the United States; and (ii) the Board has determined pursuant to section 4(c)(13) of the BHC Act to be usual in connection with the transaction of banking or other financial operations abroad.”<sup>116</sup>

These activities are described below.

- ***Management consulting services***

As noted previously, the Board has authorized management consulting as a permissible activity under several different authorities contained in the cross-references in section 4(k) of the BHC Act. In addition to finding that management consulting services are closely related to banking for purposes of section 4(c)(8) of the BHC Act, described above, the Board also determined that providing management consulting services is usual in connection with the transaction of banking or other financial operations abroad under section 4(c)(13) of the BHC Act.<sup>117</sup> Under the Board’s regulations, a bank holding company may provide management consulting services, “including to any person with respect to nonfinancial matters, so long as the management

---

<sup>115</sup> 12 U.S.C. 1843(k)(4)(F); 12 CFR 225.86(a)(2)(vii).

<sup>116</sup> 12 U.S.C. 1843(k)(4)(G).

<sup>117</sup> 12 U.S.C. 1843(k)(4)(G); 12 CFR 225.86(b)(1).

consulting services are advisory and do not allow the financial holding company to control the person to which the services are provided.”<sup>118</sup>

In the second NPR, the Board proposed to define this financial activity without regard to the condition that the bank holding company not control a client firm because this condition was imposed to prevent bank holding companies from circumventing the prohibitions and approval requirements in the BHC Act and to prevent conflicts of interest, as described previously. However, the Board believes that this condition also serves a definitional role to distinguish management consulting from the actual conduct of the activities in which a client firm is engaged, which may be commercial in nature. Therefore, the Board has restored this condition to the definition of management consulting activities that will be considered financial for purposes of Title I.

- *Travel agency*

---

<sup>118</sup> 12 CFR 225.86(b)(1).

Operating a travel agency in connection with providing financial services was determined to be usual in connection with the transaction of banking or other financial operations abroad.<sup>119</sup> This activity could be conducted in connection with any of the financial activities listed in this appendix, such as, for example, engaging in credit card activities.<sup>120</sup>

- ***Mutual fund activities***

Organizing, sponsoring, and managing a mutual fund was determined to be usual in connection with the transaction of banking or other financial operations abroad.<sup>121</sup> This activity is in addition to, and in some ways includes, the financial activity of providing administrative services to mutual funds discussed above. Under the Board's regulations, bank holding companies are prohibited from exerting managerial control over the companies in which the mutual fund invests and must reduce their ownership to less than 25 percent of the equity of the mutual fund within one year of sponsoring the fund. These conditions do not define the essential nature of organizing, sponsoring, or managing a mutual fund. Rather, they were imposed to prevent circumvention of the investment restrictions in the BHC Act.<sup>122</sup> Therefore, they are not reflected in the appendix.

---

<sup>119</sup> 12 U.S.C. 1843(k)(4)(G); 12 CFR 225.86(b)(2).

<sup>120</sup> See 48 FR 56932, 56933 (December 27, 1983).

<sup>121</sup> 12 U.S.C. 1843(k)(4)(G); 12 CFR 225.86(b)(3).

<sup>122</sup> Furthermore, the Board's regulations governing a financial holding company's merchant banking activities authorizes the financial holding company to own all of the voting shares of a fund, but no more than 25 percent of the equity of the fund, which demonstrates that section 4(k) authorizes financial holding companies to control funds.

- ***Commercial banking activities***

Engaging in commercial banking and other banking activities was determined to be usual in connection with the transaction of banking or other financial operations abroad.<sup>123</sup> Commercial banking activities include the ownership of a bank, as well as engaging in activities and making investments permissible for a bank.<sup>124</sup> The purchase of liquidity instruments, such as U.S. government securities, is an activity that is permissible for a bank. Some commenters had suggested that assets such as liquidity instruments not be included in a company's financial revenues or assets for purposes of determining whether the company is predominantly engaged in financial activities. However, investing in bank permissible investments is intrinsic to commercial banking. Therefore, a nonbank company's purchase of liquidity instruments would be included in the company's financial revenues and assets.

**c. Implications for Bank Holding Companies**

As noted in the Second NPR, the activities listed in the appendix would be defined as financial *solely* for purposes of Title I of the Dodd-Frank Act. The appendix is

---

The limitation on a financial holding company's equity interest in a fund was a prudential limitation imposed to limit the potential losses to which the financial holding company may be exposed.

<sup>123</sup> 12 CFR 211.10(a)(1).

<sup>124</sup> The Board's regulations implementing section 4(k) of the BHC Act do not include this activity because the regulations were intended to identify the activities that may be conducted using the post-transaction notice procedures. In the preamble to the final rule implementing section 4(k), the Board expressed the view that "the GLB Act did not authorize a financial holding company to conduct commercial and other banking activities in the United States by using the post-transaction notice procedure." 66 FR 400, 405 (January 3, 2001). The fact that post-transaction notice procedures are not available for commercial or other banking activities does not impact the conclusion that engaging in commercial and other banking activities is a financial activity for purposes of determining whether a firm is predominantly engaged in financial activities under Title I.

not intended to amend section 4(k) of the BHC Act for purposes of defining those activities that are permissible for financial holding companies or the manner in which bank holding companies and financial holding companies are permitted to conduct those activities.

#### **d. Other Activities**

As described above, section 4(k) of the BHC Act authorizes the Board, in consultation with the Secretary of the Treasury, to determine in the future that additional activities are “financial in nature.”<sup>125</sup> One commenter contended that the universe of financial activities that should be included when calculating either the revenue or asset test should be frozen as of the date on which the Dodd-Frank Act was passed and should not include additional activities that the Board, in consultation with the Secretary of the Treasury, determines in the future to be “financial in nature.”

The Board has considered this comment and believes that the language of section 102 of the Dodd-Frank Act is best read as providing that any activities that are considered to be “financial in nature” at the time a company is considered under the asset or revenue test to determine whether such company is predominantly engaged in financial activities, should be included in such calculation.

Section 102 specifically provides that an activity that is “financial in nature” as defined in section 4(k) of the BHC Act, shall be considered to be a financial activity for purposes of determining whether a company is predominantly engaged in financial activities. The definition of financial activities under section 4(k) is not static, and, under

---

<sup>125</sup> See 12 U.S.C. 1843(k)(1)-(k)(3).

the terms of section 4(k), may be expanded. In light of the evolving nature of financial markets and companies, the inclusion of all activities that are considered to be financial at the time the determination is made ensures that the definition of “financial activities” for purposes of the designation process accurately reflects that evolution. This interpretation also is consistent with the statutory process that requires the Council to revisit designation decisions at least annually. This provision of the statute contemplates that a company’s status as a “nonbank financial company” would not remain static, but would be reevaluated at different times in the future. This requirement to revisit designation decisions indicates that Congress foresaw that the mix of financial and nonfinancial activities conducted by companies could change over time. A company’s mix of financial and nonfinancial activities could change in the future for various reasons, including a determination by the Board and the Secretary of the Treasury, that additional activities should be considered to be financial in nature under section 4(k).

In addition, the Board believes that this interpretation is consistent with the Council’s duties under section 112 of the Dodd-Frank Act, which include monitoring the financial services marketplace to identify potential threats to the financial stability of the United States and providing a forum for discussion and analysis of emerging market developments and financial regulatory issues. The Council’s duties and authorities contemplate that the Council will stay abreast of the evolving nature of financial activities, markets, and companies. The inclusion of all activities that are considered to be financial at the time the determination is made helps ensure that the Council fulfills its statutory duties, authorities, and purposes, including its authority to consider any company that is predominantly engaged in financial activities that could pose a threat to

U.S. financial stability for designation. The Board, as appropriate, will, on a case-by-case basis, provide assistance to companies in determining whether a particular activity is financial in nature for purposes of Title I.<sup>126</sup>

### **3. Equity investments in unconsolidated entities**

The First NPR included two rules of construction governing the application of the two-year test to revenues and assets attributable to a company's minority equity investments in unconsolidated entities. Under the first proposed rule of construction, the Board proposed to attribute to a company all revenues derived from, and assets related to, the company's equity investment in any unconsolidated company that itself is predominantly engaged in financial activities.<sup>127</sup> This rule of construction would have required companies to determine whether 85 percent or more of an investee company's revenues or assets were attributable to financial activities for purposes of determining whether to treat revenues and assets related to unconsolidated minority investments as financial. Under the second rule of construction, the Board proposed to permit (but not

---

<sup>126</sup> The First NPR proposed a formal procedure under which a company could request that the Board determine whether a particular activity is financial in nature for purposes of Title I, which was substantially similar to the procedure outlined in § 225.88 of the Board's Regulation Y under which a financial holding company or other interested entity may request a determination from the Board that an activity is financial in nature or incidental to a financial activity. The final rule contemplates that the Board and Council, as appropriate, will help companies determine whether the company is predominantly engaged in financial activities. As part of this process, the Board expects to provide assistance to companies attempting to determine whether a particular activity is financial, as appropriate, consistent with the Board's interpretive authority under the BHC Act and its authority under section 102(a)(6) of the Dodd-Frank Act. Therefore, the Board has determined that it is unnecessary to include in the final rule a formal procedure under which a company may request that the Board determine whether a particular activity is financial in nature.

<sup>127</sup> See § 225.301(e)(1) of the First NPR.

require) a company to treat as nonfinancial the revenues and assets attributable to a limited amount of *de minimis* equity investments in unconsolidated companies without having to separately determine whether the investee company is itself predominantly engaged in financial activities.<sup>128</sup>

***First Rule of Construction: Unconsolidated Investments***

Several commenters asserted that a company's minority equity investments in an unconsolidated company should not be included in a company's financial revenues or assets when determining whether such company is predominantly engaged in financial activities unless the investment was made in connection with a merchant banking investment as defined in section 4(k) of the BHC Act or was made in a subsidiary of the company. Some commenters expressed the view that requiring a company to determine whether unconsolidated investee companies are themselves predominantly engaged in financial activities would be unduly burdensome.

In light of the comments, the Board has eliminated the requirement that a company determine whether an unconsolidated company in which it has made an investment is predominantly engaged in financial activities. Rather, the Board has amended the final rule to provide that an investment in an unconsolidated company will be presumed to be made in the course of conducting a financial activity set forth in section 4(k). In the Board's experience, this presumption is appropriate because most companies that derive a significant portion of revenue from, or have significant assets related to, investments in unconsolidated companies (such as hedge funds, private equity

---

<sup>128</sup> See § 225.301(e)(2) of the First NPR.



funds, or mutual funds) generally hold those investments for purposes of resale in connection with a bona fide merchant or investment banking activity as set forth in section 4(k)(4)(H), make those investments in connection with the activity of investing for others as defined in section 4(k)(4)(A), or invest in companies engaged in financial activities as provided for in section 4(k)(1). This presumption will reduce burden on companies by allowing them to determine whether they are predominantly engaged in financial activities without having to determine whether an unconsolidated company in which it has invested is itself predominantly engaged in financial activities.<sup>129</sup> In addition, this presumption will reduce burden on companies that are required to report their credit exposure to significant bank holding companies and significant nonbank financial companies under section 165(d) of the Dodd-Frank Act, which requires companies subject to this reporting obligation to identify companies that are predominantly engaged in financial activities, and thus, nonbank financial companies.

However, the Board recognizes that the presumption will not be appropriate in all instances, such as when a company holds an investment in a supplier in order to manage its supply chain more efficiently, to otherwise integrate various aspects of the company's business, or as a joint venture to engage in a business related to the company's primary business, among other possibilities. Accordingly, a company may rebut the presumption that an investment in a particular unconsolidated company is related to a financial activity

---

<sup>129</sup> Unless this presumption is rebutted, a nonbank company's investment income, including the company's proportionate share of earnings associated with an investment accounted for under the equity method, and dividend income from investments in unconsolidated companies will be included in the company's financial revenues for purposes of the revenue test.

by providing evidence to the Council, with respect to the definition of a nonbank financial company for purposes of Title I (other than with respect to the definition of a significant nonbank financial company), or the Board, with respect to the definition of a significant nonbank financial company, that the investment is not a merchant banking investment, an investment for others, an investment in a company engaged in activities that are financial in nature, or is not otherwise related to a financial activity. The Council or the Board, as appropriate, will consider this evidence on a case-by-case basis to determine whether the revenues derived from, or the assets related to, a company's investment in an unconsolidated company should be considered to be financial revenues or assets of the company.

The Board also has amended the first rule of construction to clarify that it would apply to a nonbank company's investment in an unconsolidated company, regardless of whether this investment would constitute a "minority" investment under applicable accounting standards. This amendment is intended to address circumstances in which an investor holds more than a majority of an investee company's voting shares but has granted substantive participating rights or similar rights to minority shareholders and, therefore, does not have a controlling financial interest under applicable accounting standards.

***Second Rule of Construction: De Minimis Investments***

As noted above, the first NPR contained a second rule of construction that would permit (but not require) a company to treat as nonfinancial the revenues and assets attributable to investments in unconsolidated companies representing less than five percent of any class of outstanding voting shares, and less than 25 percent of the total

equity, of the unconsolidated company without having to separately determine whether those companies are themselves predominantly engaged in financial activities.<sup>130</sup> This rule of construction was subject to several conditions designed to limit the potential for these de minimis investments to substantially alter the financial character of the activities of a company.<sup>131</sup>

In light of the rebuttable presumption discussed above, which provides that the Board will presume that a company's investments in unconsolidated companies are financial as either a merchant banking investment under section 4(k)(4)(H), an investment made for others under section 4(k)(4)(A), or an investment in a company engaged in activities that are financial in nature under section 4(k)(1), and the company's ability to rebut the presumption in consultation with the Board, the second rule of construction is no longer necessary. The Council or the Board as appropriate, will, on a case-by-case basis, consider whether a particular investment is related to an activity that is financial in nature as defined in section 4(k), including investments representing less

---

<sup>130</sup> See § 225.301(e)(2) of the First NPR.

<sup>131</sup> Specifically, this rule of construction provided that a company may treat revenues derived from, or assets related to, an equity investment by the company in an investee company as revenues or assets not derived from, or related to, activities that are financial in nature (regardless of the type of activities conducted by the other company), if (i) the company owns less than five percent of any class of outstanding voting shares, and less than 25 percent of the total equity, of the investee company; (ii) the financial statements of the investee company are not consolidated with those of the company under applicable accounting standards; (iii) the company's investment in the investee company is not held in connection with the conduct of any financial activity (such as, for example, investment advisory activities or merchant banking investment activities) by the company or any of its subsidiaries; (iv) the investee company is not a bank, bank holding company, broker-dealer, insurance company, or other regulated financial institution; and (v) the aggregate amount of revenues or assets treated as nonfinancial under the rule of construction in any year does not exceed five percent of the company's annual gross financial revenues or consolidated total financial assets of the company.

than five percent of any class of the unconsolidated investee company's outstanding voting shares, and less than 25 percent of the unconsolidated investee company's total equity.

#### **4. Characterization of Internal Financial Activities and Certain Assets**

Several commenters requested that the Board clarify whether revenues derived from, or assets related to, internal financial activities should be included as financial revenues or assets when determining whether a company is predominantly engaged in financial activities.

As the Board explained in the First NPR, the definition of financial activities includes all activities that have been, or may be, determined to be “financial in nature” under section 4(k) regardless of where the activity is conducted by a company or whether the company is conducting the activity on an internal or inter-affiliate basis or with a third-party. This view is consistent with the language of the Dodd-Frank Act. Section 102(a)(6) does not distinguish between financial activities conducted internally or those conducted with third parties. This is in sharp contrast to the specific terms of sections 113(c) and 167(b) of the Dodd-Frank Act, which provide that the Board may require a nonbank financial company to conduct its financial activities in an intermediate holding company “*other than*” internal financial activities, including internal treasury, investment, and employee benefit functions.<sup>132</sup> The absence of such an exclusion in section 102(a)(6) indicates that Congress intended that internal financial activities be

---

<sup>132</sup> 12 U.S.C. 5323(c) and 5367(b). See also section 626 of the Dodd-Frank Act; 12 U.S.C. 1467b.

included for purposes of determining whether a company is predominantly engaged in financial activities as defined in section 102(a)(6).

In addition, some commenters requested that the Board clarify that particular assets, such as cash, goodwill and other intangibles, and accounts receivable that relate to the company's financing a non-financial activity or product, are not included in a company's assets related to financial activities for purposes of determining whether the company is predominantly engaged in financial activities.

The Dodd-Frank Act compares assets related to financial activities to a firm's total assets. Cash on hand is not easily mapped to or necessarily used to fund a particular financial activity. Moreover, while a firm may be able to trace the generation of cash to a particular activity internally, the Dodd-Frank Act also contemplates that third parties be able to determine whether a firm is predominantly engaged in financial activities.<sup>133</sup> Third parties are not privy to the type of internal documentation that would allow them to assess whether cash is related to a particular financial activity. Consequently, the final rule excludes cash from a company's consolidated total assets and consolidated total financial assets for purposes of determining whether a company is predominantly engaged in financial activities under the asset test. However, inflows of cash generally may be attributed to particular activities for purposes of the revenue test in the Dodd-

---

<sup>133</sup> As previously discussed, section 165(d)(2) of the Dodd-Frank Act requires nonbank financial companies supervised by the Board and bank holding companies and foreign banks treated as bank holding companies with \$50 billion or more in assets to report their credit exposure to significant nonbank financial companies and bank holding companies, which requires companies subject to this reporting obligation be identify those companies that are predominantly engaged in financial activities, and thus, nonbank financial companies.

Frank Act using the company's cash flow statement. Thus, all revenues, including cash, that are derived from financial activities must be included in the revenue test.

Holdings of cash equivalents represent investments and are, therefore, related to the financial activity of making bank-permissible investments. Therefore, cash equivalents are assets related to a financial activity for purposes of the asset test.

Intangible assets generally may be attributed to a particular activity. Accordingly, the final rule treats each intangible asset in the same manner as the transaction or asset that *gives rise* to the intangible asset. An intangible asset is a financial asset of the company for purposes of the asset test only to the extent that it is related to the conduct of a financial activity. For example, mortgage servicing rights generate an intangible asset derived from an activity determined to be financial under section 4(k) of the BHC Act. On the other hand, goodwill, which is generally recognized as an intangible asset, is generated when a company makes an acquisition at a premium over the fair value of the asset acquired. The final rule allows exclusion of goodwill from the company's consolidated total assets and consolidated total financial assets for purposes of determining whether a company is predominantly engaged in financial activities under the asset test.

Accounts receivable may, in some cases, be related to the financial activity of extending credit, such as when the firm charges the customer interest over a term in exchange for the credit after a product or service is delivered. In other cases, a company's accounts receivable may simply reflect an agreement to accept payment from customers on a specified date for the company's goods and services. In those instances, the company may simply have provided its customers an accommodation to provide

payment by a certain date with no credit terms such as interest. Because accounts receivable may in some cases reflect a company's extensions of credit, the Board has determined that it is most appropriate to treat accounts receivable as related to a financial activity unless a company rebuts this presumption by providing evidence to the Council, with respect to the definition of a nonbank financial company for purposes of Title I (other than with respect to the definition of a significant nonbank financial company), or the Board, with respect to the definition of a significant nonbank financial company, that the receivable is not related to extending credit. As is the case with respect to the other presumptions adopted by the Board in this rulemaking, this presumption will help companies determine whether they are predominantly engaged in financial activities and will reduce burden on companies that are required to report their credit exposure to significant nonbank financial companies under section 165(d) of the Dodd-Frank. A company may rebut this presumption by providing evidence to the Council or the Board that the receivable is not related to extending credit, and the evidence will be considered on a case-by-case basis to determine whether the receivable should be considered to be related to a financial activity.

As noted previously, the Board recognizes that determining whether and the extent to which particular revenues or assets are related to financial activities may be a complex endeavor, and the Council and the Board, as appropriate, will assist companies on a case-by-case basis that require assistance in determining whether the company is predominantly engaged in financial activities.

## **5. Appropriate Accounting Standards**

Under the two-year test set forth in the First NPR, the amount of a company's financial revenues and financial assets would be calculated as a percentage of the company's consolidated annual gross revenues and consolidated total assets, respectively, as determined under and in accordance with 1) U.S. generally accepted accounting principles (GAAP), if the company uses GAAP in the ordinary course of its business in preparing its consolidated financial statements, 2) International Financial Reporting Standards (IFRS), if the company uses IFRS in the ordinary course of its business in preparing its consolidated financial statements, or 3) such other accounting standards that the Board determines are appropriate.<sup>134</sup> The final rule retains this provision, but provides that the Council, with respect to the definition of a nonbank financial company for purposes of Title I of the Dodd-Frank Act (other than with respect to the definition of a significant nonbank financial company), or the Board, with respect to the definition of a significant nonbank financial company, may determine that an accounting standard other

---

<sup>134</sup> For example, one commenter requested that the Board clarify that statutory accounting principles (SAP) would qualify as an appropriate accounting standard for calculating a firm's financial revenues and financial assets. The commenter indicated that some insurance companies, for example, prepare their financial statements in accordance with SAP and are not required by insurance law or regulation to prepare financial statements in accordance with GAAP. A company could request that the Council or the Board, as appropriate, permit the company to use an alternative accounting standard, such as SAP. A company seeking to use an alternative accounting standard for purposes of determining whether it is predominantly engaged in financial activities should provide information to the Council or the Board that describes why the proposed alternative accounting standard likely would ensure a presentation of the company's consolidated revenues and assets in a manner that reliably allows a determination of whether the firm meets or does not meet the statutory test for a nonbank financial company.



than GAAP or IFRS is appropriate on a case-by-case basis.<sup>135</sup> In determining whether an accounting standard other than GAAP or IFRS is appropriate, the Board expects that the Council and the Board would consider various factors, including whether the accounting standard is used by the company in the ordinary course of its business in preparing its consolidated financial statements. Reliance on an accounting standard that the company uses in the ordinary course reduces the potential for companies to arbitrage the 85 percent financial test by changing the accounting standards used for these purposes.

As the Board explained in the First NPR, the rule allows companies to use their consolidated, year-end financial statements (prepared in accordance with the accounting standards discussed above) as the basis for determining their annual gross revenues and consolidated assets for purposes of the two-year test. This methodology is likely to provide a transparent, accurate, and comparable basis for determining such amounts across companies and, thus, should facilitate the ability of a company, the Council, and the Board to determine whether a company is a nonbank financial company for purposes of Title I of the Dodd-Frank Act. Moreover, allowing companies to use the year-end consolidated financial statements that they already prepare for financial reporting or other purposes should help reduce potential burden.

## **6. Timing of Determination**

The final rule provides the Council and the Board with the flexibility, in appropriate circumstances, to consider whether a company meets the statute's 85 percent financial revenue or asset test based on the full range of information that may be

---

<sup>135</sup> See § 242.2(a)(3) of the Final Rule.

available concerning the company's activities and assets (including information obtained from other Federal or state financial supervisors or agencies) *at any time* rather than only as reflected in the company's year-end consolidated financial statements.<sup>136</sup>

For example, the Board notes that the mix of a company's revenues or assets, as well as the risks the company could pose to the U.S. financial system, may change significantly and quickly as a result of various types of transactions or actions, such as a merger, consolidation, acquisition, establishment of a new business line, or the initiation of a new activity. Moreover, these transactions and actions may occur at any time during a company's fiscal year and, accordingly, the effects of the transactions or actions may not be reflected in the year-end consolidated financial statements of the company for several months.

Section 242.3(a)(3) of the final rule would allow the Council, with respect to the definition of a nonbank financial company for purposes of Title I (other than with respect to the definition of a significant nonbank financial company), or the Board, with respect to the definition of a significant nonbank financial company, to promptly consider the effect of changes in the nature or mix of a company's activities as a result of such a transaction or action. The Board expects that the Council and the Board would conduct such a case-by-case review of whether a company is predominantly financial only when justified by the circumstances. In addition, this authority would enable the Council and the Board, in appropriate circumstances, to determine whether a company that does not

---

<sup>136</sup> See § 242.3(a)(3) of the Final Rule.

prepare consolidated financial statements is predominantly engaged in financial activities through consultation with the company.

## **B. Significant Nonbank Financial Company and Significant Bank Holding Company**

As discussed above, the Dodd-Frank Act requires the Board to define the terms “significant nonbank financial company” and “significant bank holding company” by rule.<sup>137</sup>

The First NPR defined a “significant nonbank financial company” to mean (i) any nonbank financial company supervised by the Board; and (ii) any other nonbank financial company that had \$50 billion or more in total consolidated assets as of the end of its most recently completed fiscal year. The final rule retains this definition. The final rule defines a “significant bank holding company,” as “any bank holding company or company that is, or is treated in the United States as, a bank holding company, that had \$50 billion or more in total consolidated assets as of the end of the most recently completed calendar year” as reported by the bank holding company or company that is, or is treated in the United States as, a bank holding company on the appropriate Federal Reserve form.

Several commenters provided suggestions regarding the \$50 billion asset threshold established in the proposed definitions of “significant nonbank financial

---

<sup>137</sup> See sections 102(a)(7) of the Dodd-Frank Act; 12 U.S.C. 5311(a)(7). These terms are used in two places in the Dodd-Frank Act. First, under section 113, the Council must consider the relationships of a nonbank financial company with significant nonbank financial companies and significant bank holding companies in determining whether the nonbank financial company should be subjected to supervision by the Federal Reserve (12 U.S.C. 5323(a)(2), (b)(2)). Second, under section 165(d)(2), nonbank financial companies and bank holding companies with \$50 billion or more of total consolidated assets must file credit reports that include their exposures to significant nonbank financial companies and significant bank holding companies (12 U.S.C. 5365(d)(2)).

company” and “significant bank holding company.” One commenter requested that the Board adjust the threshold for inflation, and another commenter suggested that the Board define “significant nonbank financial company” to include only those firms that the Council has designated for Board supervision under section 113 and eliminate that portion of the definition based on the \$50 billion asset threshold.

The Board designed the threshold to provide a transparent standard that other companies and the Council may use in meeting their respective statutory obligations to consider the relationships of companies with “significant” nonbank financial companies and bank holding companies. The requirement that firms calculate their exposure to significant nonbank financial companies and bank holding companies based on widely-used and transparent standards likely will reduce the burden imposed on the Council and those firms that are required to calculate their exposure to significant entities.

In establishing this threshold, the Board considered its supervisory experience with bank holding companies. The Board also considered the fact that Congress established \$50 billion in total consolidated assets as the threshold (without an inflation adjustment) at which bank holding companies should be subject to enhanced prudential supervision without any special determination by the Council that the bank holding company’s failure would pose a threat to financial stability. The Board also notes that a company that meets the definition of either a “significant” nonbank financial company or bank holding company would not be subject to any additional supervision or regulation by virtue of that definition.

For these reasons, the Board has concluded that there is a sufficient basis for adopting the \$50 billion threshold for purposes of defining “significant” nonbank

financial companies and bank holding companies. The Board has determined not to include an inflation adjustment provision in the final rule. An inflation adjustment would add complexity and burden to the definition without any significant benefit in more accurately defining the relevant terms. However, the Board may consider amending the \$50 billion threshold in the future if the Board determines that such reconsideration is appropriate.

Several commenters suggested that the Board exclude certain assets from the calculation of a nonbank financial company's "total consolidated assets," despite the consolidation of such assets on the company's balance sheet under GAAP or other appropriate accounting standards. For instance, several commenters requested that the Board exclude managed assets and investment fund assets when calculating the total assets of the asset manager or fund adviser in situations in which applicable accounting standards provide for the consolidation of such assets on the balance sheets of the asset manager and the fund adviser, respectively. The commenters contended that exclusion of such assets was appropriate, because such assets are not the at-risk assets of the manager or adviser.

Another commenter requested that the calculation of the \$50 billion threshold with respect to asset managers and fund advisers exclude capitalized goodwill and other intangibles that are not financial assets that are impacted by temporary market movements, and for which the clients have no direct or indirect ownership interest. Commenters also suggested that separate investment funds managed by the same investment adviser not be consolidated when measuring total consolidated assets of the adviser. With respect to the definition of a "significant bank holding company," one

commenter suggested that the \$50 billion asset calculation should include only the U.S.-based assets of the bank holding company or foreign bank treated as a bank holding company, rather than the company's worldwide consolidated assets.

The Board has considered these comments and has retained the requirements in the final rule that the calculation of "total consolidated assets" of a nonbank financial company include a company's worldwide consolidated assets as determined in accordance with GAAP, IFRS, or other appropriate accounting standards. The Board believes that the determination of total consolidated assets based on applicable accounting principles provides a reliable, uniform (across a given accounting framework), and simple approach that is most readily applied by the Council, the Board, and affected companies with the least burden. Any other approach would require the Council, the Board, and affected companies to obtain information from the "significant" firms and make adjustments to the reported assets of the firm, which would be burdensome and potentially unreliable.

The Board also has retained the proposed definition of a "significant bank holding company" as any bank holding company or foreign bank or company that is treated as a bank holding company that had \$50 billion or more in total consolidated assets as of the end of the most recently completed calendar year (as reported by the bank holding company or foreign bank on the appropriate Federal Reserve form), based on the bank holding company's consolidated worldwide assets. Using worldwide consolidated assets measures the significance of a bank holding company and, as above, imposes the least burden on the Council, the Board, and the relevant entities.

Several commenters requested that the Board highlight the distinction between “significant” nonbank financial companies and nonbank financial companies that are designated by the Council for supervision by the Board under section 113 of the Dodd-Frank Act. Qualifying as a significant nonbank financial company is not tantamount to a determination by the Council to subject a nonbank financial company to heightened prudential supervision by the Board under section 113 of the Dodd-Frank Act. A company that is considered to be a significant bank holding company or a significant nonbank financial company does not become subject to any additional supervision or regulation by virtue of that definition.

One commenter expressed concern that the proposed rule neither established a procedure under which a company could determine whether it were a “significant” nonbank financial company, nor imposed a requirement that a company calculate or publish its classification as significant. Like the proposed rule, the final rule does not impose a requirement that a company determine whether it meets the definition of either a “significant” nonbank financial company or bank holding company, because a company is not required to report its status as “significant” to the Board. Rather, the determination regarding a company’s status as “significant” as provided in the final rule is intended to be self-executing and based on readily available financial statements.

One commenter suggested that the Board consider defining “significant” companies differently for purposes of sections 113 and 165(d)(2) of the Act. As the Board discussed in the proposed rule, while the Board alone is responsible for defining “significant” nonbank financial companies and bank holding companies for purposes of section 113, the Board and the FDIC are jointly responsible for developing rules to

implement the credit exposure reporting requirements under section 165(d)(2), under which nonbank financial companies supervised by the Board and bank holding companies and foreign banks treated as bank holding companies with \$50 billion or more in assets must report their credit exposure to “significant” nonbank financial companies and bank holding companies. The Board and the FDIC sought comment on a joint proposed rule on April 12, 2011, to implement the provisions of section 165(d), including the credit exposure reporting requirements.<sup>138</sup> The joint proposed rule adopted the same definitions of the terms “significant” nonbank financial company and bank holding company as proposed by the Board in the First NPR, and as adopted in this final rulemaking.

Several commenters requested that the final rule address circumstances under which a determination that a company is a significant nonbank financial company or bank holding company would be treated by the Board as confidential under the Freedom of Information Act. Other commenters requested that the Board refrain from publishing a list of significant nonbank financial companies and bank holding companies.

Because neither the statute nor the final rule requires a significant nonbank financial company or bank holding company to report its status as “significant” to the Board, the statute and the final rule also do not require the Board to make a determination regarding whether a nonbank financial company or bank holding company is “significant.” Moreover, because the Dodd-Frank Act imposes requirements on certain

---

<sup>138</sup> See 76 FR 22648 (2011). The Board and FDIC issued a final rule implementing several of the provisions of section 165(d) on November 1, 2011. The agencies did not finalize the credit exposure reporting requirement at that time. See 76 FR 67323, 67327 (November 1, 2011).



firms that deal with “significant” nonbank financial companies and bank holding companies, and not on the nonbank financial companies or bank holding companies themselves, it is important that firms that must identify significant companies can do so without impediments on the availability of information.

### **III. Administrative Law Matters**

#### **A. Paperwork Reduction Act**

In accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. Ch. 3506; 5 CFR 1320 Appendix A.1), the Board reviewed this final rule under the authority delegated to the Board by the Office of Management and Budget (“OMB”). The final rule contains no collections of information under the PRA. See 44 U.S.C. 3502(3).

Accordingly, there is no paperwork burden associated with the final rule.<sup>139</sup>

One commenter asserted that the Board’s analysis of the proposed rule under the Paperwork Reduction Act was insufficient because the proposal did not contain any notice or request for comment regarding any collection of information to determine whether a company would be considered to be a “significant nonbank financial company.” However, neither the statute nor the final rule requires: (i) a “significant” nonbank financial company or bank holding company to report its status as “significant” to the Board, or (ii) the Board to make such a determination regarding a nonbank

---

<sup>139</sup> As described previously, the First NPR proposed a formal procedure under which a company could request in writing a determination from the Board as to whether a particular activity is financial in nature. However, the Board believes that it is unnecessary to include in the final rule a formal procedure under which a company may request in writing that the Board determine whether a particular activity is financial in nature. The elimination of this formal procedure from the final rule has eliminated all potential paperwork burden associated with this final rule.

financial company or bank holding company. For these reasons, the Board does not anticipate conducting or sponsoring the collection of any information related to the Board’s establishment of the definitions of “significant” nonbank financial company” and “significant” bank holding company in this final rule.

## **B. Regulatory Flexibility Act**

In accordance with Section 4(a) of the Regulatory Flexibility Act, 5 U.S.C. 601 et seq. (“RFA”), the Board must publish a final regulatory flexibility analysis with this rulemaking. The RFA requires an agency either to provide a final regulatory flexibility analysis with a final rule for which a general notice of proposed rulemaking is required or to certify that the final rule will not have a significant economic impact on a substantial number of small entities. Based on its analysis and for the reasons stated below, the Board believes that the final rule will not have a significant economic impact on a substantial number of small entities. Nevertheless, the Board is publishing a final regulatory flexibility analysis.

In accordance with sections 102(b) and 102(a)(7) of the Dodd-Frank Act, the Board is adopting Regulation PP (12 CFR 242 et seq.) to establish the criteria for determining if a company is “predominantly engaged in financial activities” and to define the terms “significant nonbank financial company” and “significant bank holding company.”<sup>140</sup> The reasons and justifications for the rule are described in the **Supplementary Information**. As discussed in the **Supplementary Information**, the criteria and definitions that are established by the rule are relevant to the authority of the

---

<sup>140</sup> 12 U.S.C. 5311(a)(7) and (b).

Council to require that a nonbank financial company become subject to consolidated prudential supervision by the Board, because material financial distress at the company, or the nature, scope, size, scale, concentration, interconnectedness, or mix of the company's activities, could pose a threat to the financial stability of the United States.

Although asset size may not be the determinative factor of whether a company may pose systemic risks, it is an important consideration.<sup>141</sup> Under regulations issued by the Small Business Administration ("SBA"), firms within the "Finance and Insurance" sector are considered "small" if they have asset sizes that vary from \$7 million or less in assets to \$175 million or less in assets.<sup>142</sup> The Board believes that the Finance and Insurance sector constitutes a reasonable universe of firms for these purposes because such firms generally engage in activities that are financial in nature. A financial firm that is at or below these size thresholds is not likely to be designated by the Council under section 113 of the Dodd-Frank Act because material financial distress at such a firm, or the nature, scope, size, scale, concentration, interconnectedness, or mix of its activities, is not likely to pose a threat to the financial stability of the United States.<sup>143</sup>

In addition, as described in the Supplementary Information, the Board also has taken several steps to reduce the potential burden of the rule on all companies that may be

---

<sup>141</sup> See 77 FR 21637 (April 11, 2012).

<sup>142</sup> 13 CFR 121.201.

<sup>143</sup> The terms "significant nonbank financial company" and "significant bank holding company" also are used in the credit exposure reporting provisions of section 165(d) of the Dodd-Frank Act, which apply to bank holding companies and foreign banks that are treated as a bank holding company that have \$50 billion or more in assets (as well as nonbank financial companies supervised by the Board). Bank holding companies and foreign banks subject to these credit exposure reporting requirements substantially exceed the \$175 million asset threshold at which a banking entity is considered "small" under regulations issued by the SBA.

affected by the rule. These steps include allowing companies to use their consolidated, year-end financial statements prepared in accordance with GAAP or IFRS as the basis for determining whether they are predominantly engaged in financial activities, and establishing a rule of construction governing the application of the two-year test to revenues and assets attributable to a company's unconsolidated investments. In addition, the presumptions adopted by the Board in connection with determining whether a company is predominantly engaged in financial activities will reduce burden on companies attempting to determine whether they are predominantly engaged in financial activities and on companies that are required to report their credit exposure to significant bank holding companies and significant nonbank financial companies under section 165(d) of the Dodd-Frank Act.

One commenter expressed the view that although it is unlikely that companies with less than \$175 million in assets would be designated by the Council, in the event that a money market mutual fund were designated, small businesses, municipal entities, and small non-profit organizations that invest in the fund would face higher costs. Furthermore, the commenter argued that a money market mutual fund that was designated would likely be less active in the short term debt markets, which would lead to less liquid and more expensive markets for small municipal and governmental entities that issue commercial paper. For these reasons, the commenter asserted that the RFA requires the Board to perform a cost-benefit analysis of its proposed rules because the

RFA applies even in those instances in which a regulation does not directly apply to an entity, but directly affects it.<sup>144</sup>

The question of whether the RFA requires consideration of the indirect application of a rule has been considered by the courts, which have held that the RFA only requires an analysis of how a rule affects small entities that would be directly subject to its requirements.<sup>145</sup> As described above, the final rule establishes the criteria for determining if a company is “predominantly engaged in financial activities” and defines the terms “significant nonbank financial company” and “significant bank holding

---

<sup>144</sup> The commenter cited to Aeronautical Repair Station Ass’n, Inc. v. FAA, 494 F.3d 161, 177 (D.C. Cir. 2007). In that case, the FAA regulation at issue required employees who performed certain functions “directly or by contract (including by subcontract at any tier)” to be subject to drug and alcohol testing. The commenter stated that the “court rejected arguments that an RFA analysis was unnecessary because contractors of air carriers were not ‘directly regulated’ and were not the ‘targets’ of the regulation. The commenter asserted that the court held that contractors were ‘subject to the proposed regulation’ for purposes of the RFA even though the regulation was ‘immediately addressed’ to the air carriers, because the regulations applied to employees of the contractors, just as it applied to employees of the air carriers. The contractors were ‘directly affected and therefore regulated’ within the meaning of the RFA.”

<sup>145</sup> See Mid-Tex Elec. Coop v. FERC, 773 F.2d 327 (D.C. Cir. 1985) and American Trucking Ass’ns v. EPA, 175 F.3d 1027, 1044 (D.C. Cir 1999), aff’d in part and rev’d in part on other grounds, Whitman v. American Trucking Ass’ns, 531 U.S. 457 (2001). In Mid-Tex, the court rejected the argument that “the RFA is intended to apply to all rules that affect small entities, whether the small entities are directly regulated or not,” and held that the RFA requires agencies to consider the “economic impact” of a regulation on “a substantial number of small entities that are subject to the requirements” of the regulation. See 773 F.2d at 342 (emphasis added). The court further stated that “Congress did not intend to require that every agency consider every indirect effect that any regulation might have on small businesses in any stratum of the national economy.” See id. at 343. The court in Aeronautical Repair Station, the case cited by the commenter, distinguished Mid-Tex and its progeny from the facts in that case, in which the regulations at issue “expressly require[d] that the employees of contractors and subcontractors be tested” for drug and alcohol use. See 494 F.3d at 177. For this reason, the court in Aeronautical Repair Station found that the rule at issue “impose[d] responsibilities directly on the contractors and subcontractors and they [we]re therefore parties affected by and regulated by it.” See id. (emphasis added).

company,” which are relevant to the authority of the Council to designate a nonbank financial company for consolidated prudential supervision by the Board, because the nonbank financial company could pose a threat to the financial stability of the United States. The final rule does not impose requirements directly on any entity.<sup>146</sup> Moreover, as the Board noted in the First NPR, it is extremely unlikely that a company with less than \$175 million in assets would be designated. As such, the Board believes that the final rule will not have a significant economic impact on a substantial number of small entities.

The same commenter also asserted that the Board is required to perform a cost benefit analysis under Executive Order 13579. The Executive Order cited by the commenter does not mandate that independent agencies such as the Board perform a cost benefit analysis of their regulations. However, the Board takes seriously the importance of evaluating the burdens imposed by its rulemaking efforts. For example, the Board seeks to adopt final rules that faithfully reflect the statutory provisions and Congressional intent while minimizing regulatory burden. In addition, the Board provides an analysis of the costs to small entities of its rules consistent with the RFA and computes the anticipated cost of paperwork for affected entities consistent with the Paperwork Reduction Act in its rulemaking. As described above, the Board conducted a final regulatory flexibility analysis and an analysis under the PRA in connection with this rulemaking.

---

<sup>146</sup> 12 U.S.C. 5311(a)(7) and (b).

## **List of Subjects in 12 CFR Part 242**

Administrative practice and procedure, Holding companies, Nonbank financial companies

### **Authority and Issuance**

For the reasons stated in the preamble, the Board adds new Part 242 to Chapter II of Title 12 as follows:

## **PART 242 – DEFINITIONS RELATING TO TITLE I OF THE DODD-FRANK ACT (REGULATION PP)**

Sec.

242.1 Authority and purpose.

242.2 Definitions.

242.3 Nonbank companies “predominantly engaged” in financial activities.

242.4 Significant nonbank financial companies and significant bank holding companies.

Appendix A to Part 242 - Financial Activities for Purposes of Title I of the Dodd-Frank Act

**Authority:** 12 U.S.C. 5311.

### **§ 242.1 Authority and purpose.**

(a) Authority. This part is issued by the Board pursuant to sections 102(a)(7) and (b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) (12 U.S.C. 5311(a)(7) and (b)).

(b) Purpose. (1) This part establishes the criteria for determining if a company is “predominantly engaged in financial activities” as required under section 102(b) of the Dodd-Frank Act (12 U.S.C. 5311(b)) for purposes of Title I of the Dodd-Frank Act.

(2) This part defines the terms “significant nonbank financial company” and “significant bank holding company” as provided in section 102(a)(6) of the Dodd-Frank Act for purposes of—

(i) Section 113 of the Dodd-Frank Act (12 U.S.C. 5323) relating to the designation of nonbank financial companies by the Financial Stability Oversight Council (Council) for supervision by the Board; and

(ii) Section 165(d)(2) of the Dodd-Frank Act (12 U.S.C. 5365(d)(2)) relating to the credit exposure reports required to be filed by—

(A) A nonbank financial company supervised by the Board; and

(B) A bank holding company or foreign bank subject to the Bank Holding Company Act (BHC Act) (12 U.S.C. 1841 et seq.) that has \$50 billion or more in total consolidated assets.

## **§ 242.2 Definitions.**

For purposes of this part, the following definitions shall apply:

Applicable accounting standards.—The term “applicable accounting standards” with respect to a company means:

(1) U.S. generally accepted accounting principles (GAAP), if the company uses GAAP in the ordinary course of its business in preparing its consolidated financial statements;



(2) International Financial Reporting Standards (IFRS), if the company uses IFRS in the ordinary course of its business in preparing its consolidated financial statements, or

(3) Such other accounting standards that the Council, with respect to the definition of a nonbank financial company for purposes of Title I of the Dodd-Frank Act (other than with respect to the definition of a significant nonbank financial company), or the Board, with respect to the definition of a significant nonbank financial company, determines are appropriate on a case-by-case basis.

Foreign nonbank financial company.—The term “foreign nonbank financial company” means a company (other than a company that is, or is treated in the United States, as a bank holding company) that is—

(1) Incorporated or organized in a country other than the United States; and

(2) Predominantly engaged in (including through a branch in the United States) financial activities as defined in § 242.3 of this part.

Nonbank financial company.—The term “nonbank financial company” means a U.S. nonbank financial company and a foreign nonbank financial company.

Nonbank financial company supervised by the Board.—The term “nonbank financial company supervised by the Board” means a nonbank financial company or other company that the Council has determined under section 113 of the Dodd-Frank Act (12 U.S.C. 5323) should be supervised by the Board and for which such determination is still in effect.

State.—The term “State” includes any State, commonwealth, territory, or possession of the United States, the District of Columbia, the Commonwealth of Puerto

Rico, the Commonwealth of the Northern Mariana Islands, American Samoa, Guam, and the United States Virgin Islands.

U.S. nonbank financial company.—The term “U.S. nonbank financial company” means a company that—

(1) Is incorporated or organized under the laws of the United States or any State;

(2) Is predominantly engaged in financial activities as defined in § 242.3 of this part; and

(3) Is not—

(i) A bank holding company;

(ii) A Farm Credit System institution chartered and subject to the provisions of the Farm Credit Act of 1971 (12 U.S.C. 2001 et seq.);

(iii) A national securities exchange (or parent thereof), clearing agency (or parent thereof, unless the parent is a bank holding company), security-based swap execution facility, or security-based swap data repository that, in each case, is registered with the Securities and Exchange Commission as such; or

(iv) A board of trade designated as a contract market (or parent thereof), a derivatives clearing organization (or parent thereof, unless the parent is a bank holding company), a swap execution facility, or a swap data repository that, in each case, is registered with the Commodity Futures Trading Commission as such.

**§ 242.3 Nonbank companies “predominantly engaged” in financial activities.**

(a) In general. A company is “predominantly engaged in financial activities” for purposes of this section if—

(1) The consolidated annual gross financial revenues of the company in either of its two most recently completed fiscal years represent 85 percent or more of the company's consolidated annual gross revenues (as determined in accordance with applicable accounting standards) in that fiscal year;

(2) The consolidated total financial assets of the company as of the end of either of its two most recently completed fiscal years represent 85 percent or more of the company's consolidated total assets (as determined in accordance with applicable accounting standards) as of the end of that fiscal year; or

(3) The Council, with respect to the definition of a nonbank financial company for purposes of Title I of the Dodd-Frank Act (other than with respect to the definition of a significant nonbank financial company), or the Board, with respect to the definition of a significant nonbank financial company, determines, based on all the facts and circumstances, that—

(i) The consolidated annual gross financial revenues of the company represent 85 percent or more of the company's consolidated annual gross revenues; or

(ii) The consolidated total financial assets of the company represent 85 percent or more of the company's consolidated total assets.

(b) Consolidated annual gross financial revenues. For purposes of this section, the “consolidated annual gross financial revenues” of a company means that portion of the consolidated annual gross revenues of the company (as determined in accordance with applicable accounting standards) that are derived, directly or indirectly, by the company or any of its subsidiaries from—

(1) Activities that are financial in nature; or

(2) The ownership, control, or activities of an insured depository institution or any subsidiary of an insured depository institution.

(c) Consolidated total financial assets. For purposes of this section, the “consolidated total financial assets” of a company means that portion of the consolidated total assets of the company (as determined in accordance with applicable accounting standards) that are related to—

(1) Activities that are financial in nature; or

(2) The ownership, control, or activities of an insured depository institution or any subsidiary of an insured depository institution.

(d) Activities that are financial in nature -- (1) In general. For purposes of determining whether a company is predominantly engaged in financial activities under this section, activities that are financial in nature are set forth in the appendix to this part. Nothing in this part limits the authority of the Board under any other provision of law or regulation to modify the activities determined to be financial in nature for purposes of this section or for purposes of the BHC Act or to provide interpretations of section 4(k) of the BHC Act.

(2) Effect of other authority. Any activity described in the appendix is financial in nature for purposes of this part regardless of whether—

(i) A bank holding company (including a financial holding company or a company that is, or is treated in the United States as, a bank holding company) may be authorized to engage in the activity, or own or control shares of a company engaged in such activity, under any other provisions of the BHC Act or other Federal law including, but not limited to, section 4(a)(2), section 4(c)(5), section 4(c)(6), section 4(c)(7), section

4(c)(9), or section 4(c)(13) of the BHC Act (12 U.S.C. 1843(a)(2), (c)(5), (c)(6), (c)(7), (c)(9), or (c)(13)) and the Board's implementing regulations; or

(ii) Other provisions of Federal or state law or regulations prohibit, restrict, or otherwise place conditions on the conduct of the activity by a bank holding company (including a financial holding company or a company that is, or is treated in the United States, as a bank holding company) or bank holding companies generally.

(e) Rules of construction. For purposes of determining whether a company is predominantly engaged in financial activities under this section—

(1) Unconsolidated investments. (i) Unless otherwise determined by the Council or the Board in accordance with paragraph (e)(1)(ii) of this section, revenues derived from, and assets related to, an investment by the company in an entity whose financial statements are not consolidated with those of the company are presumed to be financial in nature.

(ii) A company may seek to rebut the presumption described in paragraph (e)(1)(i) of this section by providing evidence to the Council, with respect to the definition of a nonbank financial company for purposes of Title I of the Dodd-Frank Act (other than with respect to the definition of a significant nonbank financial company), or the Board, with respect to the definition of a significant nonbank financial company, that the shares or ownership interests are not held in connection with a bona fide merchant or investment banking activity, are not held in connection with the activity of investing for others, do not represent an investment in an entity engaged in activities that are financial in nature as defined in the appendix, or are not otherwise related to a financial activity.

(2) Accounts receivable. (i) Unless otherwise determined by the Council or the Board in accordance with paragraph (e)(2)(ii) of this section, an account receivable is presumed to be an asset related to the financial activity of extending credit.

(ii) A company may seek to rebut the presumption described in paragraph (e)(2)(i) of this section by providing evidence to the Council, with respect to the definition of a nonbank financial company for purposes of Title I of the Dodd-Frank Act (other than with respect to the definition of a significant nonbank financial company), or the Board, with respect to the definition of a significant nonbank financial company, that the account receivable is not related to a financial activity.

(3) Goodwill. Goodwill is excluded from a company's consolidated total assets and consolidated total financial assets.

(4) Cash and cash equivalents. (i) Cash is excluded from a company's consolidated total assets and consolidated total financial assets.

(ii) Cash equivalents are assets related to a financial activity.

(5) Intangible assets. Intangible assets are treated in the same manner as the transaction or asset that gives rise to the intangible asset.

**§ 242.4      Significant nonbank financial companies and significant bank holding companies.**

For purposes of Title I of the Dodd-Frank Act, the following definitions shall apply:

(a) Significant nonbank financial company. A “significant nonbank financial company” means—

(1) Any nonbank financial company supervised by the Board; and

(2) Any other nonbank financial company that had \$50 billion or more in total consolidated assets (as determined in accordance with applicable accounting standards) as of the end of its most recently completed fiscal year.

(b) Significant bank holding company. A “significant bank holding company” means any bank holding company or company that is, or is treated in the United States as, a bank holding company, that had \$50 billion or more in total consolidated assets as of the end of the most recently completed calendar year, as reported on either the Federal Reserve’s FR Y-9C (Consolidated Financial Statement for Bank Holding Companies), or any successor form thereto, or the Federal Reserve’s Form FR Y-7Q (Capital and Asset Report for Foreign Banking Organizations), or any successor form thereto.

#### **Appendix A to Part 242 - Financial Activities for Purposes of Title I of the Dodd-Frank Act**

(a) Lending, exchanging, transferring, investing for others, or safeguarding money or securities.

(b) Insuring, guaranteeing, or indemnifying against loss, harm, damage, illness, disability, or death, or providing and issuing annuities, and acting as principal, agent, or broker for purposes of the foregoing, in any state.

(c) Providing financial, investment, or economic advisory services, including advising an investment company (as defined in section 3 of the Investment Company Act of 1940).

(d) Issuing or selling instruments representing interests in pools of assets permissible for a bank to hold directly.

(e) Underwriting, dealing in, or making a market in securities.

(f) Engaging in any activity that the Board has determined to be so closely related to banking or managing or controlling banks as to be a proper incident thereto, which include—

(1) Extending credit and servicing loans. Making, acquiring, brokering, or servicing loans or other extensions of credit (including factoring, issuing letters of credit and accepting drafts) for the company's account or for the account of others.

(2) Activities related to extending credit. Any activity usual in connection with making, acquiring, brokering or servicing loans or other extensions of credit, including the following activities:

(i) Real estate and personal property appraising. Performing appraisals of real estate and tangible and intangible personal property, including securities.

(ii) Arranging commercial real estate equity financing. Acting as intermediary for the financing of commercial or industrial income-producing real estate by arranging for the transfer of the title, control, and risk of such a real estate project to one or more investors.

(iii) Check-guaranty services. Authorizing a subscribing merchant to accept personal checks tendered by the merchant's customers in payment for goods and services, and purchasing from the merchant validly authorized checks that are subsequently dishonored.

(iv) Collection agency services. Collecting overdue accounts receivable, either retail or commercial.





(v) Credit bureau services. Maintaining information related to the credit history of consumers and providing the information to a credit grantor who is considering a borrower's application for credit or who has extended credit to the borrower.

(vi) Asset management, servicing, and collection activities. Engaging under contract with a third party in asset management, servicing, and collection<sup>1</sup> of assets of a type that an insured depository institution may originate and own.

(vii) Acquiring debt in default. Acquiring debt that is in default at the time of acquisition.

(viii) Real estate settlement servicing. Providing real estate settlement services.<sup>2</sup>

(3) Leasing personal or real property. Leasing personal or real property or acting as agent, broker, or adviser in leasing such property if:

(i) The lease is on a nonoperating basis;<sup>3</sup>

(ii) The initial term of the lease is at least 90 days; and

---

<sup>1</sup> Asset management services include acting as agent in the liquidation or sale of loans and collateral for loans, including real estate and other assets acquired through foreclosure or in satisfaction of debts previously contracted.

<sup>2</sup> For purposes of this section, real estate settlement services do not include providing title insurance as principal, agent, or broker.

<sup>3</sup> The requirement that the lease is on a nonoperating basis means that the company does not, directly or indirectly, engage in operating, servicing, maintaining, or repairing leased property during the lease term. For purposes of the leasing of automobiles, the requirement that the lease is on a nonoperating basis means that the company does not, directly or indirectly: (1) provide servicing, repair, or maintenance of the leased vehicle during the lease term; (2) purchase parts and accessories in bulk or for an individual vehicle after the lessee has taken delivery of the vehicle; (3) provide the loan of an automobile during servicing of the leased vehicle; (4) purchase insurance for the lessee; or (5) provide for the renewal of the vehicle's license merely as a service to the lessee where the lessee could renew the license without authorization from the lessor.

(iii) In the case of leases involving real property:

(A) At the inception of the initial lease, the effect of the transaction will yield a return that will compensate the lessor for not less than the lessor's full investment in the property plus the estimated total cost of financing the property over the term of the lease from rental payments, estimated tax benefits, and the estimated residual value of the property at the expiration of the initial lease; and

(B) The estimated residual value of property for purposes of paragraph (f)(3)(iii)(A) of this section shall not exceed 25 percent of the acquisition cost of the property to the lessor.

(4) Operating nonbank depository institutions.

(i) Industrial banking. Owning, controlling, or operating an industrial bank, Morris Plan bank, or industrial loan company that is not a bank for purposes of the BHC Act.

(ii) Operating savings associations. Owning, controlling, or operating a savings association.

(5) Trust company functions. Performing functions or activities that may be performed by a trust company (including activities of a fiduciary, agency, or custodial nature), in the manner authorized by federal or state law that is not a bank for purposes of section 2(c) of the Bank Holding Company Act.

(6) Financial and investment advisory activities. Acting as investment or financial advisor to any person, including (without, in any way, limiting the foregoing):

(i) Serving as investment adviser (as defined in section 2(a)(20) of the Investment Company Act of 1940, 15 U.S.C. 80a-2(a)(20)), to an investment company registered

under that act, including sponsoring, organizing, and managing a closed-end investment company;

(ii) Furnishing general economic information and advice, general economic statistical forecasting services, and industry studies;

(iii) Providing advice in connection with mergers, acquisitions, divestitures, investments, joint ventures, leveraged buyouts, recapitalizations, capital structurings, financing transactions and similar transactions, and conducting financial feasibility studies;<sup>4</sup>

(iv) Providing information, statistical forecasting, and advice with respect to any transaction in foreign exchange, swaps, and similar transactions, commodities, and any forward contract, option, future, option on a future, and similar instruments;

(v) Providing educational courses, and instructional materials to consumers on individual financial management matters; and

(vi) Providing tax-planning and tax-preparation services to any person.

(7) Agency transactional services for customer investments.

(i) Securities brokerage. Providing securities brokerage services (including securities clearing and/or securities execution services on an exchange), whether alone or in combination with investment advisory services, and incidental activities (including related securities credit activities and custodial services).

(ii) Riskless principal transactions. Buying and selling in the secondary market all types of securities on the order of customers as a “riskless principal” to the extent of

---

<sup>4</sup> Feasibility studies do not include assisting management with the planning or marketing for a given project or providing general operational or management advice.

engaging in a transaction in which the company, after receiving an order to buy (or sell) a security from a customer, purchases (or sells) the security for its own account to offset a contemporaneous sale to (or purchase from) the customer.

(iii) Private placement services. Acting as agent for the private placement of securities in accordance with the requirements of the Securities Act of 1933 (1933 Act) and the rules of the Securities and Exchange Commission.

(iv) Futures commission merchant. Acting as a futures commission merchant for unaffiliated persons in the execution, clearance, or execution and clearance of any futures contract and option on a futures contract.

(v) Other transactional services. Providing to customers as agent transactional services with respect to swaps and similar transactions, any transaction described in paragraph (f)(8) of this appendix, any transaction that is permissible for a state member bank, and any other transaction involving a forward contract, option, futures, option on a futures or similar contract (whether traded on an exchange or not) relating to a commodity that is traded on an exchange.

(8) Investment transactions as principal.

(i) Underwriting and dealing in government obligations and money market instruments. Underwriting and dealing in obligations of the United States, general obligations of states and their political subdivisions, and other obligations that state member banks of the Federal Reserve System may be authorized to underwrite and deal in under 12 U.S.C. 24 and 335, including banker's acceptances and certificates of deposit.

(ii) Investing and trading activities. Engaging as principal in:

(A) Foreign exchange;

(B) Forward contracts, options, futures, options on futures, swaps, and similar contracts, whether traded on exchanges or not, based on any rate, price, financial asset (including gold, silver, platinum, palladium, copper, or any other metal), nonfinancial asset, or group of assets, other than a bank-ineligible security,<sup>5</sup> if—

(1) A state member bank is authorized to invest in the asset underlying the contract;

(2) The contract requires cash settlement;

(3) The contract allows for assignment, termination, or offset prior to delivery or expiration, and the company—

(i) Makes every reasonable effort to avoid taking or making delivery of the asset underlying the contract; or

(ii) Receives and instantaneously transfers title to the underlying asset, by operation of contract and without taking or making physical delivery of the asset; or

(4) The contract does not allow for assignment, termination, or offset prior to delivery or expiration and is based on an asset for which futures contracts or options on futures contracts have been approved for trading on a U.S. contract market by the Commodity Futures Trading Commission, and the company--

(i) Makes every reasonable effort to avoid taking or making delivery of the asset underlying the contract; or

(ii) Receives and instantaneously transfers title to the underlying asset, by operation of contract and without taking or making physical delivery of the asset.

---

<sup>5</sup> A bank-ineligible security is any security that a state member bank is not permitted to underwrite or deal in under 12 U.S.C. 24 and 335.

(C) Forward contracts, options,<sup>6</sup> futures, options on futures, swaps, and similar contracts, whether traded on exchanges or not, based on an index of a rate, a price, or the value of any financial asset, nonfinancial asset, or group of assets, if the contract requires cash settlement.

(iii) Buying and selling bullion, and related activities. Buying, selling and storing bars, rounds, bullion, and coins of gold, silver, platinum, palladium, copper, and any other metal for the company's own account and the account of others, and providing incidental services such as arranging for storage, safe custody, assaying, and shipment.

(9) Management consulting and counseling activities.

(i) Management consulting.

(A) Providing management consulting advice:<sup>7</sup>

(1) On any matter to unaffiliated depository institutions, including commercial banks, savings and loan associations, savings banks, credit unions, industrial banks, Morris Plan banks, cooperative banks, industrial loan companies, trust companies, and branches or agencies of foreign banks;

(2) On any financial, economic, accounting, or audit matter to any other company.

---

<sup>6</sup> This reference does not include acting as a dealer in options based on indices of bank-ineligible securities when the options are traded on securities exchanges. These options are securities for purposes of the federal securities laws and bank-ineligible securities for purposes of section 20 of the Glass-Steagall Act, 12 U.S.C. 337. Similarly, this reference does not include acting as a dealer in any other instrument that is a bank-ineligible security for purposes of section 20. Bank holding companies that deal in these instruments must do so in accordance with the Board's orders on dealing in bank-ineligible securities.

<sup>7</sup> In performing this activity, companies are not authorized to perform tasks or operations or provide services to client institutions either on a daily or continuing basis, except as necessary to instruct the client institution on how to perform such services for itself. See also the Board's interpretation of bank management consulting advice (12 CFR 225.131).

(B) Revenues derived from, or assets related to, a company's management consulting activities under this subparagraph will not be considered to be financial if the company:

(1) Owns or controls, directly or indirectly, more than 5 percent of the voting securities of the client institution; or

(2) Allows a management official, as defined in 12 CFR 212.2(h), of the company or any of its affiliates to serve as a management official of the client institution, except where such interlocking relationship is permitted pursuant to an exemption permitted by the Board.

(C) Up to 30 percent of a nonbank company's assets or revenues related to management consulting services provided to customers not described in paragraph (f)(9)(i)(A)(1) or regarding matters not described in paragraph (f)(9)(i)(A)(2) of this appendix will be included in the company's financial assets or revenues.

(ii) Employee benefits consulting services. Providing consulting services to employee benefit, compensation and insurance plans, including designing plans, assisting in the implementation of plans, providing administrative services to plans, and developing employee communication programs for plans.

(iii) Career counseling services. Providing career counseling services to:

(A) A financial organization<sup>8</sup> and individuals currently employed by, or recently displaced from, a financial organization;

---

<sup>8</sup> Financial organization refers to insured depository institution holding companies and their subsidiaries, other than nonbanking affiliates of diversified savings and loan holding companies that engage in activities not permissible under section 4(c)(8) of the Bank Holding Company Act (12 U.S.C. 1842(c)(8)).



(B) Individuals who are seeking employment at a financial organization; and

(C) Individuals who are currently employed in or who seek positions in the finance, accounting, and audit departments of any company.

(10) Support services.

(i) Courier services. Providing courier services for:

(A) Checks, commercial papers, documents, and written instruments (excluding currency or bearer-type negotiable instruments) that are exchanged among banks and financial institutions; and

(B) Audit and accounting media of a banking or financial nature and other business records and documents used in processing such media.<sup>9</sup>

(ii) Printing and selling MICR-encoded items. Printing and selling checks and related documents, including corporate image checks, cash tickets, voucher checks, deposit slips, savings withdrawal packages, and other forms that require Magnetic Ink Character Recognition (MICR) encoding.

(11) Insurance agency and underwriting.

(i) Credit insurance. Acting as principal, agent, or broker for insurance (including home mortgage redemption insurance) that is:

(A) Directly related to an extension of credit by the company or any of its subsidiaries; and

---

<sup>9</sup> See also the Board's interpretation on courier activities (12 CFR 225.129), which sets forth conditions for company entry into the activity.

(B) Limited to ensuring the repayment of the outstanding balance due on the extension of credit<sup>10</sup> in the event of the death, disability, or involuntary unemployment of the debtor.

(ii) Finance company subsidiary. Acting as agent or broker for insurance directly related to an extension of credit by a finance company<sup>11</sup> that is a subsidiary of a company, if:

(A) The insurance is limited to ensuring repayment of the outstanding balance on such extension of credit in the event of loss or damage to any property used as collateral for the extension of credit; and

(B) The extension of credit is not more than \$10,000, or \$25,000 if it is to finance the purchase of a residential manufactured home<sup>12</sup> and the credit is secured by the home; and

(C) The applicant commits to notify borrowers in writing that:

(1) They are not required to purchase such insurance from the applicant;

(2) Such insurance does not insure any interest of the borrower in the collateral;

and

---

<sup>10</sup> Extension of credit includes direct loans to borrowers, loans purchased from other lenders, and leases of real or personal property so long as the leases are nonoperating and full-payout leases that meet the requirements of paragraph (f)(3) of this appendix.

<sup>11</sup> Finance company includes all non-deposit-taking financial institutions that engage in a significant degree of consumer lending (excluding lending secured by first mortgages) and all financial institutions specifically defined by individual states as finance companies and that engage in a significant degree of consumer lending.

<sup>12</sup> These limitations increase at the end of each calendar year, beginning with 1982, by the percentage increase in the Consumer Price Index for Urban Wage Earners and Clerical Workers published by the Bureau of Labor Statistics.

(3) The applicant will accept more comprehensive property insurance in place of such single-interest insurance.

(iii) Insurance in small towns. Engaging in any insurance agency activity in a place where the company or a subsidiary has a lending office and that:

(A) Has a population not exceeding 5,000 (as shown in the preceding decennial census); or

(B) Has inadequate insurance agency facilities, as determined by the Board, after notice and opportunity for hearing.

(iv) Insurance-agency activities conducted on May 1, 1982. Engaging in any specific insurance-agency activity<sup>13</sup> if the company, or subsidiary conducting the specific activity, conducted such activity on May 1, 1982, or received Board approval to conduct such activity on or before May 1, 1982.<sup>14</sup> Revenues derived from, or assets related to, a company's specific insurance agency activity under this clause will be considered financial only if the company:

(A) Engages in such specific insurance agency activity only at locations:

(1) In the state in which the company has its principal place of business (as defined in 12 U.S.C. 1842(d));

---

<sup>13</sup> Nothing contained in this provision precludes a subsidiary that is authorized to engage in a specific insurance-agency activity under this clause from continuing to engage in the particular activity after merger with an affiliate, if the merger is for legitimate business purposes.

<sup>14</sup> For the purposes of this paragraph, activities engaged in on May 1, 1982, include activities carried on subsequently as the result of an application to engage in such activities pending before the Board on May 1, 1982, and approved subsequently by the Board or as the result of the acquisition by such company pursuant to a binding written contract entered into on or before May 1, 1982, of another company engaged in such activities at the time of the acquisition.

(2) In any state or states immediately adjacent to such state; and

(3) In any state in which the specific insurance-agency activity was conducted (or was approved to be conducted) by such company or subsidiary thereof or by any other subsidiary of such company on May 1, 1982; and

(B) Provides other insurance coverages that may become available after May 1, 1982, so long as those coverages insure against the types of risks as (or are otherwise functionally equivalent to) coverages sold or approved to be sold on May 1, 1982, by the company or subsidiary.

(v) Supervision of retail insurance agents. Supervising on behalf of insurance underwriters the activities of retail insurance agents who sell:

(A) Fidelity insurance and property and casualty insurance on the real and personal property used in the operations of the company or its subsidiaries; and

(B) Group insurance that protects the employees of the company or its subsidiaries.

(vi) Small companies. Engaging in any insurance-agency activity if the company has total consolidated assets of \$50 million or less. Revenues derived from, or assets related to, a company's insurance-agency activities under this paragraph will be considered financial only if the company does not engage in the sale of life insurance or annuities except as provided in paragraphs (f)(11) (i) and (iii) of this appendix, and does not continue to engage in insurance-agency activities pursuant to this provision more than 90 days after the end of the quarterly reporting period in which total assets of the company and its subsidiaries exceed \$50 million.

(vii) Insurance-agency activities conducted before 1971. Engaging in any insurance-agency activity performed at any location in the United States directly or indirectly by a company that was engaged in insurance-agency activities prior to January 1, 1971, as a consequence of approval by the Board prior to January 1, 1971.

(12) Community development activities.

(i) Financing and investment activities. Making equity and debt investments in corporations or projects designed primarily to promote community welfare, such as the economic rehabilitation and development of low-income areas by providing housing, services, or jobs for residents.

(ii) Advisory activities. Providing advisory and related services for programs designed primarily to promote community welfare.

(13) Money orders, savings bonds, and traveler's checks. The issuance and sale at retail of money orders and similar consumer-type payment instruments; the sale of U.S. savings bonds; and the issuance and sale of traveler's checks.

(14) Data processing.

(i) Providing data processing, data storage and data transmission services, facilities (including data processing, data storage and data transmission hardware, software, documentation, or operating personnel), databases, advice, and access to such services, facilities, or data-bases by any technological means, if the data to be processed, stored or furnished are financial, banking or economic.

(ii) Up to 30 percent of a nonbank company's assets or revenues related to providing general purpose hardware in connection with providing data processing

products or services described in paragraph (f)(14)(i) of this appendix will be included in the company's financial assets or revenues.

(15) Administrative services. Providing administrative and other services to mutual funds.

(16) Securities exchange. Owning shares of a securities exchange.

(17) Certification authority. Acting as a certification authority for digital signatures and authenticating the identity of persons conducting financial and nonfinancial transactions.

(18) Employment histories. Providing employment histories to third parties for use in making credit decisions and to depository institutions and their affiliates for use in the ordinary course of business.

(19) Check cashing and wire transmission. Check cashing and wire transmission services.

(20) Services offered in connection with banking services. In connection with offering banking services, providing notary public services, selling postage stamps and postage-paid envelopes, providing vehicle registration services, and selling public transportation tickets and tokens.

(21) Real estate title abstracting.

(g) Engaging, in the United States, in any activity that a bank holding company may engage in outside of the United States; and the Board has determined, under regulations prescribed or interpretations issued pursuant to section 4(c)(13) of the BHC Act (12 U.S.C. 1843(c)(13)) to be usual in connection with the transaction of banking or other financial operations abroad. Those activities include—

(1) Providing management consulting services, including to any person with respect to nonfinancial matters, so long as the management consulting services are advisory and do not allow the company to control the person to which the services are provided.

(2) Operating a travel agency in connection with financial services.

(3) Organizing, sponsoring, and managing a mutual fund.

(4) Commercial banking and other banking activities.

(h) Directly, or indirectly acquiring or controlling, whether as principal, on behalf of 1 or more entities, or otherwise, shares, assets, or ownership interests (including debt or equity securities, partnership interests, trust certificates, or other instruments representing ownership) of a company or other entity, whether or not constituting control of such company or entity, engaged in any activity not financial in nature as defined in this appendix if:

(1) Such shares, assets, or ownership interests are acquired and held as part of a bona fide underwriting or merchant or investment banking activity, including investment activities engaged in for the purpose of appreciation and ultimate resale or disposition of the investment;

(2) Such shares, assets, or ownership interests are held for a period of time to enable the sale or disposition thereof on a reasonable basis consistent with the financial viability of the activities described in paragraph (h)(1) of this appendix; and

(3) During the period such shares, assets, or ownership interests are held, the company does not routinely manage or operate such company or entity except as may be

necessary or required to obtain a reasonable return on investment upon resale or disposition.

(i) Directly or indirectly acquiring or controlling, whether as principal, on behalf of 1 or more entities, or otherwise, shares, assets, or ownership interests (including debt or equity securities, partnership interests, trust certificates or other instruments representing ownership) of a company or other entity, whether or not constituting control of such company or entity, engaged in any activity not financial in nature as defined in this appendix if—

(1) Such shares, assets, or ownership interests are acquired and held by an insurance company that is predominantly engaged in underwriting life, accident and health, or property and casualty insurance (other than credit-related insurance) or providing and issuing annuities;

(2) Such shares, assets, or ownership interests represent an investment made in the ordinary course of business of such insurance company in accordance with relevant state law governing such investments; and

(3) During the period such shares, assets, or ownership interests are held, the company does not routinely manage or operate such company except as may be necessary or required to obtain a reasonable return on investment.

(j) Lending, exchanging, transferring, investing for others, or safeguarding financial assets other than money or securities.

(k) Providing any device or other instrumentality for transferring money or other financial assets.



(l) Arranging, effecting, or facilitating financial transactions for the account of third parties.

By order of the Board of Governors of the Federal Reserve System, March 29, 2013.

---

Robert deV. Frierson,  
Secretary of the Board.

BILLING CODE 6210-01-P

[FR Doc. 2013-07688 Filed 04/04/2013 at 8:45 am; Publication Date: 04/05/2013]